United States Court of Appeals

for the Second Circuit

JOINT APPENDIX

76-7278

Volume A-3
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United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-7278

B

MARGARET MARY MCDONNELL MURPHY,
Plaintiff-Appellant,

against

MCDONNELL & CO., INCORPORATED and THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, President,
Defendants.

JAMES F. MCDONNELL, JR., individually, as Trustee under the Will of James F. McDonnell and as Executor of the Estate of Anna M. McDonnell, and CHARLES E. MCDONNELL, as Executor of the Estate of Anna M. McDonnell,
Plaintiff-Appellants,

against

THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, THE NEW YORK STOCK EXCHANGE, INC., THE AMERICAN STOCK EXCHANGE by H. VERNON LEE, JR., Secretary, and MCDONNELL & CO., INC.,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JOINT APPENDIX (Vol. A-3)

UNITED STATES COURT OF APPEALS
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October 8, 1976.

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MARGARET MARY McDONNELL MURPHY, et al.
v.
McDONNELL & CO., INC., et al.

May 2, 1975,
10 A.M.

--

(In open court, jury present.)

MR. BROOKS: Your Honor, before we start off a few housekeeping details that I would like to bring to the Court's attention. Our reporters have been doing an excellent job with the daily transcript. However, yesterday afternoon's transcript has three errors that I think are significant enough to get changed. I wondered if I could put that in the record now.

THE COURT: Have you and Mr. Beebe talked about this?

MR. BEEBE: I didn't know about this. I think it would be more appropriate to do it during the recess.

ANDREW R. McELROY, resumed.

DIRECT EXAMINATION CONTINUED

BY MR. BEEBE:

Q Mr. McElroy, I believe that when we left off yesterday you were testifying about the results of your examination of McDonnell's books and records between

February and April, 1969. Do you recall that line of inquiry?

A Generally, yes.

Q That was the subject matter we were talking about. Exhibit 21, which is in evidence, was a memorandum dated March 28, 1969, concerning a discussion of the examiner's findings. I asked you yesterday about those findings, to summarize them, and I believe you testified that, at page 629 of yesterday's transcript, "Well, my findings were that the net capital ratio, books and records problems."

What were the problems that you had found in going into McDonnell & Company's books and records at that point in 1969, sir?

A Well, I think in my report I reported a capital ratio of over 2,000, and I also reported that because of this new computer system, which they were trying to install, and various related problems, that they had a problem in keeping accurate books and records.

Q I think you said you reported. I gather you eventually put this into a written report?

A Yes. That was our method.

Q Do you recall doing an outline of that report first?

A Yes.

Q I show you a document which is two pages and it has previously been marked as Exhibit 62 for identification at the depositions, headed "Out of Report, Andrew McElroy." Was that the outline you prepared, or a copy of it?

A Yes, I believe so.

MR. BEEBE: I offer that in evidence.

MR. BROOKS: Your Honor, again, I object to the pencil markings that appear on the exhibit that has been offered. At the time it was marked as a deposition exhibit it had no pencil underlinings on the first page that now appear on the document offered.

MR. BEEBE: I apologize, your Honor. Over the years there have been marks made on some of these and we may be unable to find an absolutely clean copy. I am willing to offer it in without any markings as part of the evidence.

MR. BROOKS: I have a clean copy, your Honor.

MR.BEEBE: Thank you. I have no objection if counsel furnishes me a clean copy.

THE COURT: Very good.

MR. BEEBE: This one also has some pencil markings, but I am not going to worry about them.

(Plaintiffs' Exhibit 22 received in evidence.)

Q Sir, this has various paragraphs numbered 1, 2,

3, and so on. If I could direct your attention to number 1, which reads, "Capital position as per L/F, 10/31," which is October 31, '68. Explain to the jury what LF is?

A LF stands for long form. That refers to the audited financial questionnaire which was prepared by Lybrand Ross Bros. and Montgomery and submitted by the firm as of October 31, 1968.

Q Below that there is an SF as of January 30, 1969. What does SF stand for?

A SF stands for short form, and that refers to a financial questionnaire which was prepared by McDonnell & Company itself and submitted to the exchange as of January 30,1969.

Q And, sir, going down, still in that first group, paragraph 1, there is an entry, "Capital R, 3,992 per cent." Did that stand for the capital ratio, the under the net capital rule?

A That would be the capital ratio that was computed from the answers to the financial questionnaire as of October 31st.

Q Whose answers were they, sir?

A Well, they were McDonnell's answers.

Q Not the outside auditors, this was the company's own answers?

A It is the company's answers. In this case it is certified to by the outside auditor or attested.

Q Excuse me, I cut you off.

A Or attested to.

Q So that 3,992 per cent figure was something that the company and the outside auditors had both been involved in providing the basic numbers for; is that right?

That's a confusing question. Please let me withdraw that.

When was that ratio, what date was that pertaining to?

A October 31, 1968.

Q 1968?

A That's right.

Q Now, we will go across that column and I believe there is an entry for January, 1969, January 30, 1969. What is the ratio shown for that date?

A 3825 or 3,825 per cent.

Q Now, sir, yesterday did you testify that over 2,000 per cent or 2,000 per cent itself was the violation level?

A That's correct.

Q And these were both way over that level; is that right?

A Yes.

Q So they both indicated violations; is that right?

A Yes.

Q Now, paragraph 4, if I could direct your attention, reads as follows, and I gather those were kind of notes to yours, this whole outline, so it is kind of shorthand, which you can explain to us. "McD com weekly comp did not disclose 325 violations until 1/13/69." And there is a check mark next to that even on your copy, I think.

A Yes.

Q What did youmean by that? Could you explain that for the jury?

A Well, what that means is that McDonnell & Company, the company itself, was making a weekly capital computation, and their weekly capital computations did not show a ratio of over 2,000 until January 13, 1969.

Q What did they do with those weekly capital computations after they made them, did they send them to the exchange?

A I'm not sure, I don't know.

Q Were they internal or were they something that was furnished to the exchange?

A They might have been furnished to the exchange. I don't know.

Q I gather in any case that you looked at them in the course of your --

A At this time I don't know. I probably knew at that time, but I don't recall whether they were furnishing them to the exchange at that point or not.

Q What was your occasion for looking at them in the course of your examination when you went into McDonnell & Co.?

A I don't know what my thinking was at the time, but it would obviously be a point that I would look for. I certainly would be interested in how they computed their net capital position. I don't really know exactly how I arrived at looking at it at this point in time.

Q And did you mean by this that on January 13, 1969, their only weekly computation did disclose a violation?

A Apparently.

THE COURT: Mr. McElroy, there is a figure of letters AF in one of the paragraphs, which I think you earlier defined as aggregate indebtedness.

THE WITNESS: That should probably be AI. It's a typing error. I'm sure it's meant to be AI.

Q Is the one below that, NC, that stands for net capital?

A Right.

Q Approximately when did you prepare this outline, sir?

A I would have to be a little bit vague, but I think it must have been toward the end of my examination, which would probably be late in March or early April.

Q 1969?

A That's right.

Q What did you do with the information about a violation of rule 325 and the information about the net capital ratios of October 31, 1968, being 3,992 per cent and January 30th being 3,825 per cent?

A Well, it was the subject of discussion at meetings and the subject of my report. I at this point in time don't remember everybody that was involved, but

those meetings that we talked about yesterday I'm sure were concerned with these facts.

Q Is it fair to say that you passed that information up the chain of command?

A Yes, it is.

Q Did these indicate to you serious violations?

A Sericus apparent violations.

Q These were facts, weren't they, that you had found there in the records, these numbers, these figures?

A Well, the numbers are the results of my calculations and this is what I computed at the time. We examiners are always most conservative and want to show things in the worst possible light or we wouldn't be doing our job properly. But whether this remained as the final interpretation of their capital position, I wouldn't know. That would be out of my hands.

Q Sir, yesterday you mentioned that there was a practice that had been followed of allowing things as good capital if they could be liquidated within 30 days. Do you remember that testimony?

A Yes.

Q And you also testified that that wasn't in the rules, is that right? That's not somewhere in the

rules, is it?

A I don't think it's stated as 30 days in the rule as it existed at that time. I think it merely talks about the currency of assets. I'm not sure of the terminology in the rules as to the exact words.

Q Sir, I'm putting in front of you the 1969 rules, which is one I just happened to reach for. I don't think there is any difference between '68 and '69 on that score. Is there anything in there that allows the stock exchange to interpret the rules differently than what they say on their face?

MR. BROOKS: I object to the question.

THE COURT: Yes. How is that appropriate to this witness?

MR. BEEBE: This witness has testified, your Honor, that he found an apparent violation but somehow it's not a violation.

THE COURT: I don't think it has anything to do with the question of how these rules are interpreted and what authorization there is for interpretation.

Read the question back, if you will, please.

(Question read)

THE COURT: I am going to sustain the objection to that question as put.

Q Let me ask you this way, Mr. McElroy: On page 623 of yesterday's transcript, and if there is some correction to the transcript that hasn't appeared --

MR. BROOKS: No problem on that page, Mr. Beebe.

Q You testified as follows, talking about some capital asset.

"Q Would that have to be sold within 30 days in order to qualify?

"A Probably. I don't make the exceptions, so I don't -- I really don't know.

"Q Who makes the exceptions?

"A Well, I don't know that I can answer that either. Someone who has a position senior to me. It wouldn't be made generally by the examiners department, I don't think."

My question is, as a man very familiar with the rules, under what rules are exceptions made or what rule, what provision?

A I don't know.

Q Sir, you testified yesterday about some meetings that you couldn't separate in your mind that happened concerning these findings. I show you a document -- before I show it to you, let me ask Mr. Brooks

if he does have a copy without any writing on it. I don't know whether this writing was on originally or not.

(Pause)

MR. BROOKS: The writing was on the exhibit as marked at the deposition.

Q This is a one-page memo on the heading McDonnell & Co., Inc., dated April 2, 1969. It talks about separate meetings in RMB's office. Is that a memo concerning one of the meetings you attended, sir?

A Yes, it is.

MR. BEEBE: I offer it in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 23 was received in evidence)

MR. BROOKS: Your Honor, I would like inquiry to be made, though, as to the difference between the handwriting and the typewritten portion of the memo, if the witness knows who wrote what. I think it might be somewhat confusing in its raw state.

MR. BEEBE: I have no problem with that.

THE COURT: Will you be exploring into that at this moment?

MR. BEEBE: I would be glad to.

THE COURT: Very good.

MR. BEEBE: Can I start with something else and get to that?

THE COURT: Yes.

Q Mr. McElroy, who were the people present at that meeting, according to the initials indicated in the body of this memo?

A Well, in the second line the initials indicate --

Q Excuse me, this is the exchange staff, is that right?

A This is from the exchange staff, Mr. Bishop, Mr. McChesney, Mr. Huntoon, Mr. Stock, Mr. Schuette, and myself.

Q Could we just pause for a minute there. What was Mr. McChesney's position at that time?

A Mr. McChesney was the chief examiner.

Q And Mr. Huntoon?

A I am not sure what Dave's position was at that time. He was on thestaff of the department of member firms.

Q Mr. Stock?

A He may have been an assistant vice president at that time, I am not sure, again on the staff of the department of member firms.

Q And Mr. Schuette?

A He was the coordinator who handled McDonnell & Company.

Q In the next line it talks about the people there from the firm. Is it correct Mr. McDonnell was there?

A Yes.

Q That is Murray McDonnell?

A Yes.

Q Larry O'Brien?

A Yes.

Q Tom McKay, Dave Rome, Owen Jaeger. And that is all thatis mentioned here?

A Yes, sir.

Q That was the group present, I take it?

A Yes, sir.

Q Was the subject of possible restrictions being imposed upon the firm discussed?

A That's what the memorandum states.

Q Could you explain to the jury what the role of restrictions is when they are imposed by the stock exchange on member firms?

A Well, the restrictions would be an effort to restrict the firm's business. I guess you would say the reason for that would be that because of problems that the firm was having we would be afraid that too much business would create additional problems, so it was one method of trying to curb the problems the firm was having. I think it was more in the nature of a control rather than a discipline.

Q A control bythe stock exchange over the member firms, is that right?

A That is my opinion.

Q When you mentioned problems, were you referring to the record keeping problems and the capital problems?

A Yes.

Q Restrictions when officially imposed by the stock exchange, were they a matter of public record?

A I don't think so. I think that sometimes the word was around, you know, rumor, that sort of thing, but I don't think we made that public.

Q Do you know if there was a practice to bring the fact that a firm was on restrictions to the attention of people who were potential capital investors in the firm?

A I don't know.

Q Was there any discussion at that meeting about raising more capital for the firm?

A I think so. I am not 100 per cent sure.

Q Was that the one where the discussions revolved around raising them from a gentleman you mentioned yesterday, Mr. Carey?

A I don't recall when that came up. I just remember -- that's the only name I can remember as being

mentioned, and I don't recall whether that was mentioned at a meeting or when I was over at the firm's office.

Q Now I will ask Mr. Brooks' question: The handwriting at the bottom concerning "proposed" and then there is a list of proposals, do you know what those proposals concerned?

A It would appear to be proposed restrictions.

Q The last sentence of the memo refers to a subsequent meeting held by -- and I will read out the names though there are initials here -- Mr. Stock, Mr. Huntoon, Mr. Newman, JOhn Zaremba, yourself, and Mr. Schuette, explored possible restrictions to be recommended to the "committee."

Were these the proposals discussed at that subsequent meeting?

A I assume they are. I really don't remember. This is the typical type of thing that were restrictions.

Q And they would normally be sent to the file after someone jotted them down at the meeting? Was that the normal, regular course of operation?

A I guess this was the first meeting of this type that I had attended, and I don't think I know what was normal.

Q I don't mean what you knew then. I mean

what you learned about the practice that you have since learned.

Is that the normal practice as to how these ended up in the files?

A Again, I didn't have anything -- I didn't write the memo. It probably would have been a coordinator function rather than an examiner function, and I don't really know --

Q You were present there, weren't you?

A I was present, but as far as drafting a memo and writing these things down, I didn't do it and I left the meeting and went back over to 120 Broadway to McDonnell's office, presumably to finish up.

Q It mentions the "committee," possible restrictions to be recommended to the committee. What possible restrictions did you explore recommending to the "committee"?

A It must have been these items listed here. I don't remember.

Q Could you explain what the first item is, 12,000 TPD, including underwriting?

A I believe that means trades per day.

Q And No. 2, no new branches RRS.

A Producers, I think that must be.

Q Could you explain what the No. 2 means?

A Well, it means that the restriction would be that the firm couldn't open any more branch offices and couldn't hire any more sales personnel.

Q And No. 3, capital req. What did that mean?

A It means that we were considering a capital requirement of 5 per cent of the aggregate indebtedness plus 30 per cent of short security differences.

Q How would No. 3 relate to the 20 to 1 rule, the ratio we had been talking about earlier? Would that be more stringent?

A I think that is a very difficult question to answer, because we were having some problem with how to treat short security differences for capital purposes. I think it was meant to be an additional requirement. In other words, 5 per cent of AI is your normal 20 to 1 ratio, so it would be 5 per cent of AI plus an additional capital charge relating to short security differences.

Q So would it be --

THE COURT: What is a short security difference?

THE WITNESS: A short security difference basically means that the books and records reflected that the firm was responsible for X number of shares of

stock belonging to customers, and so forth, and they were short that amount by some number of shares, which we then developed by pricing them to the market, to either develop a dollar market of those securities which in effect you might say were missing as far as the books and records were concerned. Sometimes on research you would resolve these without actually having to go out and buy them, you would find where they were located.

THE COURT: In other words, these securities would presumably be in a vault but the records might or might not show it.

THE WITNESS: They might be in a vault or due from another broker or due from some outside source, but the records didn't properly reflect that.

Q Let me skip ahead just for a minute. McDonnell & Company ultimately went out of business, is that right?

A Yes.

Q About a year after this, in March of 1970, is that correct?

A I believe that is the date they went into liquidation.

Q Why did it go out of business?

MR. BROOKS: I object, your Honor. There

is no foundation for this question for Mr. McElroy.

THE COURT: Sustained.

Q Let me pinpoint it a bit more precisely. Did their record keeping problems continue throughout 1969 and contribute to their --

THE COURT: I will sustain an objection to the form of this.

MR. BEEBE: All right, I will build a little more.

Q Coming back to this list, No. 4, restrict advertising, how does that work as a restriction?

A By restricting advertising, if you can't advertise presumably your volume of business will be reduced. The object of advertising, of course, is to bring in more business.

Q No. 5 says "knowledgeability letters." What is that?

A Knowledgeability letters are letters requested from new capital contributors stating that they are knowledgeable about the investment they are about to make and are not looking to the exchange for any special protection. I think that is the general nature.

Q Mr. McElroy, I believe you were here the other day when Mr. McDonnell, James McDonnell, testified, and

Margaret McDonnell testified, the two people sitting here, Margaret Mary McDonnell?

A No, I was only here during part of James' tetsimony.

Q Do you know if either of these two individuals signed knowledgeability letters?

A No, I don't. I think maybe James testified he did.

Q What would be the occasion for a restriction requiring knowledgeability letters? Why is that a restriction?

A I am not sure that I can properly answer that question without just speculating.

Q What was the "committee" that your group was going to make a recommendation to about possible restrictions?

A Again from my limited viewpoint as a staff man I don't know who was on the committed, or exactly how it fit into the exchange makeup. I know there was a committee, and I always presumed that it was members of the board of governors, and key staff people of the stock exchange who were making, I guess you would say making decisions about the steps that the exchange would take.

Q Sir, could you please keep your voice up?

A Say so if I don't speak loudly enough.

Q Did you know any members on the committee at that time?

A I don't think so. You mean did I know them personally or--

Q No.

A I don't think I even knew their names.

Q You didn't?

A I could probably guess at them, but I never met with them.

Q You were here in a little group, and you were going to explore possible restrictions to be recommended to the committee. What did you do after you had that meeting and it explored these possible restrictions?

A Again, that is--

Q Did you recommend them to someone?

A You see, in the nature of my job I was what you call an outside man. I left the exchange and went back to do my work at McDonnell & Company. I did not carry these recommendations anywheres. I walked away and it wasn't until a subsequent time that I would be informed what would happen.

Q What were you informed?

A My recollection is that initially I don't believe any restrictions were placed on the firm, and I think when I make that statement I also recall that the firm was restricting itself along some of these very lines, so that that would probably be the reason.

Q You knew, didn't you, by April 2nd, certainly, that the firm had what were called self-imposed restrictions?

A I don't recall at what point I learned of it. I don't recall when they started imposing these restrictions. But it is true that they did have certain self-imposed restrictions, because they recognized they had problems.

Q If I told you that it was at the end of January that they sent a letter which has been called self-imposed restrictions, would that refresh your recollection that that was the time?

A I would just have to say --

MR. BROOKS: I object to the question. It assumes that there was one time. There might have been many times.

THE COURT: Sustained.

Q You can't pinpoint it better than that?

A I just wouldn't know the date.

Q Were you a little surprised that restrictions were not imposed after this meeting on April 2nd?

A My recollection is that I had some initial surprise, but then, on the other hand--

Q Excuse me, I think it calls for a yes or no.

THE COURT: The way he started out, I don't think it does.

MR. BROOKS: May he complete his answer?

THE COURT: Yes.

A Well, the reason I say that is, again, first of all, I was not a policy maker, I was an information gatherer, or something of that nature: a financial cop is one word we have been called. But restrictions, there is a problem about restrictions. If you are trying to help --

MR. BEEBE: I object to this in response to my question, sir.

THE COURT: Frankly, whether this gentleman exhibited surprise or not I don't think has the slightest relevance at this point, and if there had been an objection I would have sustained it.

MR. BEEBE: Can I ask a further inquiry then on other topics?

THE COURT: You may. Go ahead.

MR. BROOKS: Your Honor, I would like him to complete his answer, since there was no objection, and I

don't think he has fully responded to Mr. Beebe's question, however insufficient the question was.

MR. BEEBE: The question was just whether he was surprised.

MR. BROOKS: He hasn't finished explaining. I think he should be allowed to finish.

THE COURT: To clear up this morass, how far had you gotten with your answer?

MR. BEEBE: Could I withdraw the question?

THE COURT: I am afraid not.

(Answer read.)

THE COURT: Strike out the question and answer, and disregard that, ladies and gentlemen.

Go ahead with the next question.

Q After this time when you went back to McDonnell & Company, did you prepare further notes on what you were finding there in your investigations about the financial data and the operating conditions?

A I don't remember.

Q I hand you a document which we have previously marked as 24 for identification, and ask you if that represents something that was prepared by you, the materials underneath, and whether the routing slip on the top is also familiar to you.

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A Yes, that memorandum was prepared by me. I don't know much about the routing slip.

MR. BEEBE: I offer them both in evidence.

THE WITNESS: It would appear from the routing slip that this is a return visit subsequent to my initial visit to McDonnell & Company.

MR. BEEBE: I offer them both, your Honor.

MR. BROOKS: I have some concern about the routing slip, your Honor. Mr. McElroy said he doesn't know anything about it.

MR. BEEBE: Could I put that to rest right away? There was a request to admit, your Honor, prior to the trial, and that was one of the items that was admitted.

MR. BROOKS: I don't dispute that it is authentic, but I don't know what connection it has with Mr. McElroy's testimony.

MR. BEEBE: Since it mentions him in there, and--

THE COURT: The question is whether the documents are connected.

MR. BEEBE: Whether the two are physically part and parcel of one another.

THE COURT: Yes.

MR. BEEBE: We can mark them separately, if you like. They were both admitted in response to the request

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to admit, your Honor.

MR. BROOKS: I don't dispute that they are both authentic.

THE COURT: The question is whether they belong together with a staple on them, that's what it amounts to.

MR. BROOKS: Yes. The witness said he wrote one, but not the other.

MR. BEESE: I have no problem with marking them separately, if that would please Mr. Brooks.

(Plaintiffs' Exhibits 24 and 24A received in evidence.)

Q Let's start with the one that is marked 24A. Is that your handwriting?

A Yes, sir. It is.

Q It is addressed to Hank. Who is Hank?

A Mr. George H. Newman.

Q Who is he?

A I believe he followed Mr. Schuette as coordinator. I think Mr. Schuette left the exchange about this point in time, and Mr. Newman became the coordinator.

Q What did this handwritten memo to Mr. Newman represent? Was that the culmination of some more research you had done on the premises as a financil cop for the exchange?

A Yes, it looks like I am now talking about capital as of March 27th.

Q This is updating information you had obtained earlier?

A That's right.

Q I direct your attention to paragraph 1 -- you have numbered some of the paragraphs here -- and it shows R 2,920 per cent. Is that the net capital ratio as of a later date than we talked about earlier?

A It would be my capital computation as of March 27th under certain conditions which are mentioned here in the memorandum.

Q Was your capital computation based on your examination of McDonnell's books and records on the premises of McDonnell?

A It would appear that this is the firm's capital computation to which I made certain adjustments.

Q What I am driving at is, it was you out in the field, at the premises, looking at their hands on the books, right?

A That's right.

Q The second one, I believe as of the same date, is 2,629 per cent, is that right?

A That's right.

Q Also as of March 27, 1969?

A Yes.

Q And the third one 2,522 per cent?

A That's right.

Q The next page you went back from March to January 30th, and I will read it and ask if this is right "As of January 30, 1969, per our analysis, the capital position was" and then next to R it says-- is that 3,000?

A I think that my copy isn't too clear.

Q 3,825 per cent?

A That's right.

Q What did you do with this information? You just sent it on to Hank Newman, is that what you did with it?

A I think this is probably a repetition. It says "As of January 30th," so I don't think this is the first time that had been raised.

Q You had not adjusted it? It was the same?

A I believe it is the same as something that was reported earlier. I don't know at this date.

Q And th level is 2,000, the violation level, is that right?

A That's right.

Q Further down is this sentence "My report will indicate that I believe NC was somewhat worse than this due

to reporting errors and omissions."

Was that your belief at the time, that the net capital was actually worse than that, the net capital ratio?

A That's what my memorandum says.

Q Was that your belief?

A It must have been.

Q Let's turn to the buck slip. A buck slip is a routing slip sending it from one person to another, is that right, sir? Is that what a buck slip is?

A Yes.

Q Now, this is from Mr. Newman to Mr. Stock?

MR. BROOKS: Your Honor, counsel is just asking the witness to read the memorandum. I think we can all do that. If he is asking him to do something else I am not aware of what he is asking.

MR. BEEBE: I am leading on from there.

THE COURT: Are you going to ask him about some personal acquaintance with this?

MR. BEEBE: Yes. His name is mentioned in the buck slip.

THE COURT: Why don't you direct his attention to that.

MR. BEEBE: I was trying to put it in context, sir.

Q Our reading is that it says it is from Mr. Newman to Mr. Stock, and the message, which I believe may be from Mr. Stock to Mr. Newman is "Hank: Andy is going into the firm to check the computations, isn't he?"

Is my reading correct, that this was Mr. Stock telling Mr. Newman this?

A I believe you are correct.

Q Do you recognize Mr. Stock's initial there?

A That seems -- it appears to be his initial.

Q And did you go back in or did you go in and check those computations?

A I went over several times.

Q Was Mr. Stock part of the upper brass of the member firm's department?

A Yes.

Q And this slip has a check on it, checked "for your information."

I believe when these were produced they were produced as if one was attached to the other. Would it be consistent with the practice, as you understood it there, for Mr. Newman, who was the addressee of your memo to have put a routing slip on top, clipped it and sent it on to Mr. Stock?

MR. BROOKS: I object, your Honor.

THE COURT: Yes. I don't think there is any foundation for what you are trying to establish.

Q Mr. McElroy, did there come a time when you embodied your findings in something of a somewhat more official report?

A Yes.

Q I show you a four-page document dated April 24, 1969, "Subject: Examiner's short report, member organization, McDonnell & Company." I ask you if that is a copy of a report

you prepared at that time?

A Yes, I believe that is correct.

MR. BEEBE: I offer it in evidence.

MR. BROOKS: Your Honor, there is some pencil handwriting on the front page. I wonder if we could ask the witness whether that is his. He said he prepared the report. We haven't inquired as to the handwriting yet.

THE WITNESS: I don't believe any of that handwriting is mine.

MR. BROOKS: With that description I have no objection to the report going in.

THE COURT: Minus the handwriting.

MR. BROOKS: Well, counsel maywant to try to identify the handwriting.

THE COURT: At this point it is minus the handwriting.

MR. BEEBE: I think the record should reflect the handwriting was on there when received from the stock exchange files.

THE COURT: That may be.

MR. BROOKS: I don't dispute that.

(Plaintiffs' Exhibit 25 received in evidence.)

Q Is that your signature on the fourth page, sir?

A One of them is, sir.

Q Who is the other one?

A Ed Cummings.

Q He was another examiner?

A Yes. There were three of us on this job.

Q Now, this discusses the name of the organization, the date of the visits, which says from February 18th to April 8th. And then part C, "Capital position," and then it has "Capital position per special financial questionnaire as of January 30, 1969."

Whose document is the special financial questionnaire?

A I think I described earlier that the special financial questionnaire was prepared by McDonnell & Company and filed with the exchange.

Q And what was the ratio shown on McDonnell & Company's computations as of January 30, 1969?

A I don't know.

Q It says here "Ratio, 3,825 per cent." What was that?

A That would be the ratio that was computed by an examiner at the exchange utilizing the figures on the financial questionnaire.

Q A mathematical computation?

A Well, it is a little more than a mathematical

computation, but basically that's what I mean.

Q You were one of the examiners, weren't you?

A That's right.

Q That was your responsibility?

A That was one of the examiner's responsibilities.

Q So would it be fair to say that you took McDonnell & Company's figures and you computed them to find out what the mathematical result was, in this case 3,825 per cent?

A Not me. Some examiner.

Q Was it one of you three who did it?

A I doubt it. I don't know offhand.

Q You signed this report though?

A Yes.

Q So it was either done by you or for you?

A Well, done in the normal routine of business.

Q Now, the next entry says, "After revision for questionnaire errors and adjustments."

Who makes the revisions for questionnaire errors and adjustments?

A That would be me, I'm sure.

Q What kind of revisions do you make?

A Well, as I described the examiner's job before, we would go to the firm to see that the questionnaire was

properly prepared and that the numbers on it agreed with the books and records. And when we found something that we felt was not in agreement, we would make adjustments.

Q That was the process that you went through on that visit?

A That's the process I went through, yes.

Q After all the adjustments what was the bottom line that you put there for the ratio? I mean on that second entry, "After revision for questionnaire errors and adjustments"; what was the ratio?

A 5,525 per cent.

Q Have you ever seen a ratio that high before in your life?

A I don't recall. Well, I'd better leave it at that. I just don't recall.

Q Mr. McElroy, further down in the fourth entry I believe is the ratio from the figures prepared by Lybrand, the outside accountants, as of October 31, '68. The ones we were just talking about were January 30th. As of October 31, '68, what was the ratio as computed by the examiners?

A 3,565 per cent.

Q What did "original plus 2" on that last page mean?

A That meant when this memorandum was typed there

was an original and two copies.

Q Was that customary to make only an original and two copies?

A I believe so.

Q Why were so few copies made?

A I have no idea.

Q Now --

A I believe there was some routing, normal routine routing and that's what it called for. I don't recall what the routing was.

Q Who did this report go to? Who were the recipients of the routing after you sent it out?

A Well, the original is addressed to Mr. McChesney. He is the chief examiner. One copy would remain in the file and I believe one copy would go -- would be routed to the coordinator. I'm not sure where he would rout it to.

Q Do these figures indicate an extremely serious net capital problem at McDonnell & Company?

MR. BROOKS: Object to the question.

THE COURT: Sustained as to that.

Q Sir, you mentioned, when we were talking about one of these buck slips, on the righthand side at the top -- not all the way up.

May I approach the witness, your Honor?

THE COURT: Yes.

Q Has a note "RAS, I would like to bring this 325 charge soon." Is that Mr. Stock's writing?

A That would appear to be Mr. Stock's initials.

Q Do you know who RAS was?

A I think that's Robert Spies, who is an exchange employee.

Q What position did he have at the time, do you know?

A No, I don't.

Q What is a 325 charge?

A Well, I believe what they are talking about is --

MR. BROOKS: Your Honor, I object.

THE COURT: Yes, sustained.

MR. BROOKS: Construing what somebody else was saying.

THE COURT: Particularly on the way his answer started out, sustained.

Q Do you know what a 325 charge is? Apart

from that, what in general is a 325 charge?

A It would be a disciplinary charge for violating a rule.

Q Would you explain for the jury how that disciplinary procedure works?

MR. BROOKS: Your Honor, I would first like to have a foundation that Mr. McElroy knows.

THE COURT: I agree. Sustained.

Q Mr. McElroy, in your experience at the exchange have you had occasion to be involved in any way with a company ever having disciplinary charges brought against it?

A Yes.

THE COURT: 325 disciplinary charges?

Q 325 disciplinary charges, is that included in your experience?

A The exchange is a regulartory body, amongst other things, and as such has the right to bring charges against people or companies that violate its rules.

Q Have you ever been involved as an examiner with preparing any of the information in connection with a disciplinary charge?

A Yes, I have had some relationship, yes.

Q Could you explain the relationship you have

had, the instance you were thinking of?

A Well, the charges are brought by what was at this time called the conduct division and now is called the enforcement division. They draft up a rather formal charge memorandum. I would not do that, but sometimes I have been asked about some technical aspects of the nature of the violation. That's been the extent of my involvement with charge memorandums.

Q Do you recall at that period of time whether there was any discussion at the exchange that you participated in about bringing charges against McDonnell & Company?

A No, I don't recall having been involved in such a discussion.

Q That wasn't quite what I meant. Did you hear of any discussion or any consideration being given to that subject?

A My recollection is that I believe I know that some charges were subsequently made but I'm very vague about it.

Q Do you have any idea what Mr. Stock was referring to in the note that I read?

MR. BROOKS: I object again, your Honor.

THE COURT: Other than what you read.

THE WITNESS: Other than what I read and discussed here, I don't.

Q It doesn't refresh your recollection?

A No.

Q I believe you mentioned that your job or your role was known as being a financial cop.

A That's a term that I have heard used.

Q Could you describe what that means for the jury?

A I think I already stated that our duties were to review the books and records, such as I did in this case, and attempt to establish accuracy of reporting and compliance with rules.

Q Would it be fair to say that you gather the facts, bring them back to the exchange and report them there?

A That is right.

Q Sir, you have now been talking about a document that was called the examiner's short form report. Is there also at the same time a long form report which sets forth in more detail your findings?

A That's correct.

Q I show you this document and ask you if that's the long form report.

A Well, the first page, I don't know where that came from. But the rest of it is the long report.

Q Let's take the first page off right away.

MR. BEEBE: I offer the balance of the document, which has the heading, "New York Stock Exchange, Department of Member Firms, April 24, 1969, report on visit to McDonnell & Company, Incorporated," as the next exhibit.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 28 is received in evidence)

Q I direct your attention to the last page and ask you if your signature appears there?

A Yes, it does.

Q And did you prepare this or were you one of the people preparing this report?

A Yes, I would have written or edited everything in it.

MR. BEEBE: I have no further questions about that document at this time.

Q Sir, did you continue after this April period into May and June also in your involvement with McDonnell & Company?

A I believe I did for some period of time.

Q On June 25th did you participate in a meeting with Mr. McDonnell and some people from the exchange concerning the company?

A I imagine I probably did.

Q I show you a copy of a memorandum dated June 25, 1969, and it's four pages long. The heading is just "McDonnell & Company," and it starts, "Messrs. Bishop, Stock, McElroy and Newman met with T. Murray McDonnell at 3 p.m. this afternoon," and it continues.

A It says I was there. I remember having such a meeting.

MR. BEEBE: I offer it in evidence.

MR. BROOKS: Your Honor, I don't think there has been a sufficient foundation yet for this coming into evidence. All Mr. McElroy said is that he remembers such a meeting. He hasn't said that he wrote the memo and he hasn't said that the memo accurately reflects his recollection of the meeting.

There is also a pencil marking on the third page whichwas not on the exhibit that was marked at the deposition. On the fourth page as well. I object to it.

THE COURT: Mr. McElroy, why don't you look through this while we take our recess.

THE WITNESS: All right.

(Recess)

(In open court; jury present)

Q Mr. McElroy, did you have a chance over the recess to review this document?

A Yes, I did.

Q Does it reflect what occurred at this meeting on June 25, 1969, plus a note on the bottom about something that happened later?

A It refreshes my memory up to the point where I think it says I left the meeting.

Q Fair enough. I think that is the first three pages. And the top of the fourth page.

A Yes.

Q And then later on on the fourth page it says A. McElroy and G. H. Newman went to the corporation's offices, and so on. Did that also take place?

A I believe so.

Q In other words, the memo doesn't go on and say what happened at the meeting after you left, does it?

A I think the meeting was really at an end at a point, sir.

MR. BEEBE: I offer it in evidence.

MR. BROOKS: I have no objection if we can have a clean copy substituted.

THE COURT: Very well.

(Plaintiffs' Exhibit 27 was received in evidence)

Q Now, we are in June 1969. Had McDonnell & Company, Mr. Murray McDonnell on behalf of the company, submitted at that meeting an estimated capital computation as of June 16, which showed a ratio of 2,359 per cent?

A That's what the memorandum says. I don't

specifically recall that.

Q Is that consistent with your recollection of the meeting?

A Yes.

Q It states that" "Mr. McDonnell began by saying he was completely frustrated and did not know where to turn, that there had been a $300,000'error' loss in May, that he can't believe the figures he is getting and has no confidence in his fellows."

Did Mr. McDonnell say that at that meeting?

A I think he said something to that effect, yes.

Q And in the next paragraph:

"When asked about the possibility of introducing additional capital, Mr. McDonnell stated that he was still working on adding approximately $3,500,000, which he hopes to bring in before the end of July. Regarding the introduction of additional capital immediately, Mr. McDonnell said that something cropped up an hour ago which he would like to discuss privately with Mr. Bishop."

Did he say those things, too?

A I don't recall the dollar amounts, but otherwise I would accept that as correct.

Q Thereafter, do you recall whether Mr. Murray McDonnell brought in any additional capital to the company?

MR. BROOKS: Your Honor, I don't think we have established Mr. McElroy had contact with McDonnell & Company subsequent to his meeting here. Why don't we do that first?

THE COURT: Sustained.

Q Do you know from your continued employment at the exchange, or any other source you have, whether any of this approximately $3,500,000 that Mr. Murray McDonnell was talking about did indeed come into the company?

MR. BROOKS: Same objection. We have to find out if Mr. McElroy had contact with the firm.

THE COURT: I will overrule the objection. You may answer, sir.

A I don't recall. Capital did come in at various times. I don't recall how much or when.

Q Was there any discussion at that meeting, after this was at the beginning of the meeting that this information was brought out, is that right?

I will start the question again. Was it at the beginning of the meeting that Murray McDonnell

told you these things?

A I don't remember.

Q Was there any discussion at the meeting as to the possibility of suspending the company from operations?

A I don't recall that.

Q Do you recall discussions at any time concerning the possibility of suspending the company from operations during the course of your work at the exchange?

A I believe I have some vague recollection of somebody, and I couldn't pin it down, possibly Newman, making a statement that that was a possibility. But I don't really have any firm knowledge of that.

Q Was that discussion you just referred to with Mr. Newman, would that be at the examiner's level?

A It would have just -- if --

THE COURT: Mr. Beebe, he doesn't have really a recollection of it, so there is no foundation to go on to your next question.

MR. BEEBE: I was trying to reach a little bit.

THE COURT: You better get the foundation

before you reach.

Q Can you elicit a little, can I pull out of your memory a little more about that?

A I just ha. a vague recollection at one time Hank had said something to me just in some discussion just between he and I that it was a possibility, and that's all I can recall.

Q Was this in 1969?

A Yes, but I couldn't tell you whether it was in April or November.

Q Was this in terms of something that should be done?

A It's a step that the exchange could take. Ultimately, it did take it. Other than that, I can't give you any answer.

Q Do you remember any discussion concerning the timing of steps to be taken by the exchange?

A No, I don't.

Q I have mentioned suspension. I didn't mean to limit that. Were there any discussions at this June 25 meeting about bringing charges against McDonnell & Company?

A Not that I recall.

Q What about restrictions? Were there any

discussions about the exchange imposing restrictions on this member firm?

A I think there is something in the memorandum about that. I wouldn't recall except as to what is stated in the memorandum. I think at the bottom of the second page there is a comment about restrictions.

Q Let me read that to the jury:

"Mr. McDonnell" -- this was Murray McDonnell, right?

A That's correct.

Q He was the only McDonnell at that meeting, isn't that right?

A Yes.

Q "Mr. McDonnell said that there was no need for a letter from the exchange restricting underwritings since the corporation was going to 'cut out' firm trading and underwriting."

Do you recall Mr. McDonnell saying that?

A Otherthan reading it here, I don't.

Q When charges are brought against a company, is that public information?

MR. BROOKS: I object unless counsel sets the time in which he is asking.

MR. BEEBE: 1969.

THE COURT: Public information?

MR. BEEBE: Disclosed to the public.

THE COURT: It still doesn't tell us very much.

MR. BEEBE: The witness testified that it was his belief that restrictions could be imposed privately without public disclosure. I am trying to get at whether charges are under the same circumstances.

A I believe the only time that any public information was known about charges was after any hearing had been held and results -- I think results of such hearings were sometimes publicized.

Q When charges are brought is the usual procedure for there either to be a hearing or a consent by the person or company that is charged?

A Well, there has been a change in our procedure. I would rather not answer that question.

Q You are just not sure how it worked back in 1969?

A I am just not sure how it worked back at that time.

Q Was there any discussion at this meeting about restricting the public knowledge of McDonnell's condition?

I don't think it's reflected in the memo. I am just asking you if you recall.

A No, I don't recall.

Q Do you ever recall any discussion concerning keeping the story about McDonnell under wraps?

A No.

Q Do you recall any discussion about informing the public, issuing a press release, or anything like that, about McDonnell?

A No. I don't think they would consult with me about that.

Q Who did you report to at that time?

A Lloyd McChesney.

Q Was Mr. -- you mentioned Mr. Newman at one point and Mr. Schuette. Were they the coordinators?

A Yes. And while I certainly gave them information, when you speak of reporting, the chain of command was through the examiners.

Q The chain of examiners to Mr. Schuette and then Mr. Newman?

A Generally, that was the procedure. I don't mean that I might not have spoken to them directly on occasion but our normal channels through the chain of command were the examiners and then branching out.

Q So if we skip the McChesney level the next level up would be Mr. Newman, and before him Mr. Schuette, is that right?

A Well, that's not up. That is sideways.

Q Sideways, okay. Well, what was Mr. Newman's role in 1969, the coordinator's role?

A Well, sometime in about 1968, I think, there was a change in the structure of the department of member firms. Because of the increasing paper crunch there was a move to beef up the surveillance. Whereas most of the direct followup on an examiner's report had been handled by the finance division and other areas of the department of member firms, because of the increased work load there was the establishment of this position we have been speaking about of coordinators.

Q This was before your time, 1968, is that right, when this took place?

A I worked for the exchange then, but I --

Q I didn't mean that. I mean in terms of McDonnell & Company.

A Definitely, yes.

Q And the man in 1968 who was in charge of that new coordinator's job as far as McDonnell & Company was concerned was Mr. Herb Schuette, isn't that right?

A Well, at the time of my involvement he was the coordinator. I don't know whether he was the original coordinator because there were changes.

MR. BEEBE: Why don't we call him as the next witness. I have no further direct of this witness.

THE COURT: All right.

MR. BROOKS: I have some questions, your Honor.

CROSS EXAMINATION

BY MR. BROOKS:

Q Mr. McElroy, in about February of 1939 how many member firms of the stock exchange were there to keep track of for the examiners' department?

A I believe there were over 600 at that time.

Q Do you recall the question that you were asked by Mr. Beebe this morning about whether it was unusual to only send two copies of your short form examination report, only to prepare two copies?

A Yes.

Q And you responded that that was standard operating procedure?

A That's right.

Q Did you ever receive any instruction by anyone to treat McDonnell other than in the standard way?

A Not that I recall.

Q We have talked about a back office of a brokerage firm, having back office problems. Could you describe to us the back office of a brokerage firm, and if you have McDonnell in mind maybe you can describe that back office, what it looks like, and who is there, and what records are there, and what is done there.

A Well, the back office of a brokerage firm is a

broad designation of what I would call the financial and operational area as apart from the sales and research area, and I would include in the back offices, first of all, the accounting department, or controller's department, that handles the financial books and records, and I would also include as one of the key segments the cashiering section, which involves the handling of the -- the receipt and disbursements of funds and the receipt and delivery of securities.

I would include the stock record department, which was the group that would maintain a record of the location and ownership of securities. I would include such areas as the dividend department, the data processing, or other accounting, bookkeeping type of operation.

I am sure I probably have left out a few things, but it is -- I think the term "back office" sort of designates the shirtsleeve area where you are doing detail type work.

Q I take it there would be a large number of personnel in these departments pursuing the functions of each department?

A Yes. I couldn't give you any exact numbers but I'm sure that McDonnell certainly must have had at least a hundred people. That is a guess, but it is a pretty sizable operation, depending on the size of the firm. A firm

as big as McDonnell & Company would have a number of people engaged in this.

Q Do you recall how many customers McDonnell & Company had in about February of 1969?

A I might be able to give you an answer from one of these exhibits.

Q I can help you, if you need something to refresh your recollection. I was thinking in terms of 70,000. If that's close, I am not sure.

Q I think it is probably a little high. The letter dated March 12, 1969, of Lybrand, Ross Bros. and Montgomery to McDonnell & Company, which is Trial Exhibit 20, on its last two pages notes that are indicative of this growth is the increase in number of customer accounts from approximately 17,500 in 1964 to 47,500 in 1968.

Does that 47,500 figure refresh your recollection of about what it was in February of 1969?

A Yes. Though I think it might have been bigger than that, but that is approximate.

Q That growth that Lybrand, Ross Bros. was remarking about in Exhibit 20, is that an example of the burst of activity you described yesterday resulting in the paper work crunch?

A That would be my opinion, yes.

Q And was a similar burst of growth occurring in other exchange firms at that time?

A Yes, it was.

Q Prior to that burst of growth, had the back offices of brokerage firms like McDonnell & Company kept their records in a manual manner by people taking a pencil and writing down a transaction in a ledger?

A Well, there was still some of that. I think that probably the majority of firms were using what we call mechanical bookkeeping machines, such as Burroughs machines. They would look something like an extra large typewriter which handled numbers as well as letters.

Q Did the burst of growth in the industry change how they kept records in back offices of brokerage firms?

A Yes. I'd say that it did because it was during the '60s that the majority of firms were converting more and more to data processing type equipment. It had existed prior to this time, but I think only the bigger firms, the really big firms, were using data processing type of machinery.

Q By data processing do you mean what is commonly referred to as computers?

A Well, computers entered into it, though the initial data processing I don't believe was considered to be computer

equipment. It was more electronic -- electronic bookkeeping machines where punch cards were used, and then it evolved into the computer type operation.

Q And as I recall your testimony yesterday, McDonnel attempted to convert from one of the older systems to one of these data processing systems?

A Yes, they had a data processing system, but they were attempting to improve on it, and to develop more capabilities, and it was this kind of a switchover that they were trying to make.

I am not too much of an expert on the data processing, you know, the nature of the change, all of it, except that it was generating a problem.

Q Would I be right in understanding your testimony when you said that the data was put on punch cards, that you would take data from a piece of paper where it might have once been written and then take an IBM type card and punch holes in it and push that card in a machine and expect to get out the same figures that you had on paper?

A That's right.

Q You testified that you had worked for eight years, I believe, with Haskins & Sells, is that correct?

A That's right.

Q Can you describe to the jury who Haskins & Sells

are, or were at the time?

A Haskins & Sells was a firm of Certified Public Accountants and I think they are considered to be what is generally called one of the big eight in public accounting--that is, one of the eight largest public accounting firms in the United States. They handle a complete and broad range of accounting clients, brokerages, being one of them.

Q When you say in the United States I take it you mean they have offices throughout the country?

A Throughout the country, and even foreign offices, too.

Q Was Lybrand Ross Bros. and Montgomery in 1969 a member of the big eight accounting team?

A Yes, they were, also.

Q They had a similar spread to their organization as did Haskins & Sells?

A Yes.

Q In the course of your work at Haskins & Sells, did you have occasion to conduct audits of brokerage firms?

A I was engaged in audits of brokerage firms. I don't recall that I was ever a supervisor on a brokerage audit, but I was on many brokerage audits.

Q Did you ever participate in an audit of a brokerage firm about the size of McDonnell & Company as it existed in,

say, 1969, 50,000 customer accounts and a number of branch offices?

A Yes, larger and smaller both. All sizes.

Q How does such an audit work? What do you do?

A Well, the basic object of the audit is to establish the position of the brokerage firm, the financial position, as of a given moment, as of the close of business on a given day. The audit generally starts with a large number of auditors entering the client's premises, and establishing control over the assets, in particular cash and securities, and making a complete count of all the securities and cash on the premises and also verifying what other assets are available to the firm through confirmation of those assets that are not located on the premises, such as confirming security positions that are located away from the firm, securities that are due from other brokers, and so forth, confirming with each customer directly by mail the accuracy of their monthly statement which would be mailed out to the customer under the control of the auditors, reconciling all their bank accounts, and generally verifying all the assets and liabilities so that they can arrive at a point of expressing an opinion about the financial statement.

Q And that opinion is of the statement as of that day

A As of that day.

Q They first went in?

A As of the moment of the day of the audit.

Q I think the audit of firm of McDonnell & Company was as of October 31, 1968, for 1968, is that correct?

A Yes.

Q How many people would arrive at a brokerage firm of McDonnell's size to commence an audit?

A The initial crew of auditors would be fairly large. It might be 50 or a hundred people. It depends on the accountant's estimate of the length of time it would take to do a complete security county.

Generally, the accountants do not want to tie up the brokerage operation any longer than necessary, and the ideal time to do that would be as of the close of business generally on a Friday, so that they could work through the weekend to complete the count, and once they have established the accuracy of these positions then they can release control. But it does tie the broker up for a little while. That's why you need a large group of people initially.

Q How long does the exchange provide for these auditors to do their work before they are required under the rules without extensions to render a report?

A 45 days.

Q And the rule did permit extensions, did it not?

A And the rule permitted extensions.

Q I think you testified that there were probably two extensions permitted?

A I think that is accurate.

Q Was that unusual in and about this time?

A No. I think many audits were done with time extensions.

Q Let me show you a document, Mr. McElroy, that is entitled "Answer to financial questionnaire of New York Stock Exchange as of October 31, 1968," parts 1, 2 and 3, headed McDonnell & Co., Incorporated.

I ask you if that is in essence the report that was rendered by Lybrand, Ross Bros. to the New York Stock Exchange as a result of their October 31, 1968, audit?

MR. BEEBE: Objection to "in essence." The report speaks for itself. I have no objection to it going in evidence.

MR. BROOKS: I meant "in essence" only to apply to the word "report," because it is not entitled report, but it is entitled "Answer to financial questionnaire," but I will be glad to withdraw those words if they trouble Mr. Beebe.

Q This is the report?

A Yes, it is.

MR. BROOKS: I offer that as the next exhibit. I'm sorry I had not pre-marked it.

THE COURT: It will be received.

(Defendant New York Stock Exchange Exhibit Z received in evidence.)

Q You spoke about receiving from the auditors yesterday an opinion. Do you find the opinion of the auditors in the report that I have handed you?

A Yes.

Q Can you try to give the jury an explanation of exactly what the stock exchange rules are requiring Lybrand, Ross. Bros and Montgomery to be reporting on when they undertake an audit and render a report such as this?

A Well, the New York Stock Exchange has specific regulations regarding the audit, but basically it is a requirement that they make a thorough examination of the books and records of the firm sufficient for them to express an opinion about the financial questionnaire that is being rendered, and it specifies certain things that must be done, but generally these would be audit practices and it requires that they be completed in order to express this opinion.

Q Who is the client of the auditor?

A The client of the auditor is always the member firm. The opinion is always expressed about the member firm's statement.

Q So, if I understand you correctly, it is the member firm, McDonnell & Company, that hires the auditor and it is the member firms that pays him for this task?

A That is correct.

Q I take it the member firm is required to go through this hiring process to secure an auditor and get this report up and have the auditor submit and certify it to the exchange?

A That's right. There are requirements that at the beginning of each year the firm had to file an agreement, an audit agreement with the exchange showing that they had hired a certain auditing firm to do their audit at a surprise date to be selected by the auditors during the year.

Q Does the exchange place any quality requirement on an auditor that the member firm can hire? Suppose McDonnell wanted to hire Smith & Jones of Des Moins, Iowa.

A Well, they had to be independent Certified Public Accountants. That would be the requirement.

Q Could just any independent Certified Public Accountant be engaged to a brokerage firm of this size?

A I don't think too many would have the capability of doing it.

Q And would the stock exchange have any say-so over what kind of auditing firm a particular member firm hired?

A I'm not sure of the answer to that. I think they would object if we felt that a firm was not qualified.

Q Did this audit commence on a date that was known to the member firm?

A No. It would be a surprise audit.

Q And is the element of surprise required by a stock exchange rule?

A It was at that time.

Q Do you know who signs these answers to a financial questionnaire?

A Well, the answers are attested to by two partners or voting stockholders of the firm that's answering the questionnaire. Of course, the accountants sign their opinion letter.

Q I invite your attention to the third page of the document which is a letter-- on this copy it does not have a signature. I presume it is Lybrand's, but I'm not offering that as evidence. I invite your attention to the last paragraph there, where it says, "We enclose also

the attestion form signed by officers of McDonnell & Co., Incorporated and by ourselves."

Is that a description of the attestion you were talking about?

A Yes.

Q That is an attestation to the New York Stock Exchange, is it not?

A Yes, in that the officers of the company would attest to the accuracy of the statement.

Q Do you know whether such a document as this is sent to other stock exchanges?

A Yes, I believe that the auditors-- the financial questionnaire, the audited financial questionnaire was sent to exchanges of which the member organization was also a member.

Q Do you recall which exchanges McDonnell & Co. was a member at about this time?

A Well, the American Stock Exchange I know for sure, and I think I heard mention of several others the other day.

Q Would you turn to the seventh page of Exhibit Z and tell me if the stock exchanges listed on that page as addressees refreshes your recollection as to the exthanges which McDonnell & Co. belong to?

A Yes, it does.

Q Could you read those off for the jury, since we had some testimony about that fact yesterday.

MR. BEEBE: I object because I don't see the reading of other stock exchanges has anything to do with this case. I would like to get on to the next witness.

MR. BROOKS: Your Honor, Mr. James McDonnell was asked if he knew which exchanges McDonnell & Co. belonged to. There was no objection, and he answered he knew of one or two and he thought there were others. Now, here are the others and I thought we should complete the record.

THE COURT: Is the exhibit in evidence?

MR. BROOKS: Yes, it is.

THE COURT: Go ahead. We will spend more time talking about it than reading it.

THE WITNESS: The American Stock Exchange, the New York Stock Exchange, the Boston Stock Exchange, the Pacific Coast Stock Exchange, the Detroit Stock Exchange, the Midwest Stock Exchange, the Honolulu Stock Exchange, and the Philadelphia-Baltimore-Washington Stock Exchange.

Q Now, did this report go anywhere else other than to all those exchanges?

A It went to the Securities and Exchange Commission.

Q Where are they?

A Well, I think it was sent to the New York office, headquartered in Washington, of course.

Q Can you give the jury a quick description of what the Securities and Exchange Commission is and what role it is playing in the oversight of McDonnell & Co.?

A Well, the Securities and Exchange Commission was established by the United States Government back in the mid'30s after the stock market crash, and it was established as the federal government's agency to regulate the securities business. They regulate or have the final say in the regulation of all broker-dealers and they also regulate the stock exchanges generally, too. In other words, the stock exchanges and the brokers had a responsibility to the Securities and Exchange Commission.

Q I take it the submission of Exhibit Z to the Securities and Exchange Commission is not gratuitous but done by some rule or requirement of that Commission.

A It is done by some rule or requirement, and even the format that is used was, I believe, devised both by the SEC and the stock exchange working together to come up with a reporting form that was agreeable to both.

Q Mr. McElroy, let me show you what we have previously marked as Exhibit J, which has been identified as the statement of financial condition as of October 31,

1968, for McDonnell & Company. My question to you is, how does the statement of financial condition relate to the answers to the financial questionnaire, which are Exhibit Z?

A Well, the statement of financial condition is what we would generally refer to as a balance sheet. While it contains and is based on the same books and numbers that appear on the financial questionnaire, the financial questionnaire is a different organization of those numbers designed to facilitate, amongst other things, the computation of net capital and to reflect the records of a broker-dealer.

But this is a balance sheet using the same numbers and with an opinion of the accountants attached.

Q Is the statement of financial condition the product of the same audit?

A Yes, yes.

Q And it is rendered as of the same date?

A As of the same date, right.

Q And if I understand you correctly, the bottom line ought to be the same or there is a problem; is that correct?

A That's correct, yes, sir.

Q What is the purpose of a statement of financial condition such as Exhibit J?

A Well, Exhibit J is a means of informing the clients of the brokerage firm of the condition of the

brokerage firm as of that given date.

Q Does the stock exchange or did the stock exchange in and about January or February of 1969 have any rule in respect to statements of financial condition such as Exhibit J?

A Yes, they did. Since it is changed I am a little vague about it, but I believe at that time they were required to inform their customers that this statement of financial condition would be available to them upon request.

Q As a matter of practice did many brokerage firms simply send them out to customers?

A Yes, many firms would simply print up a form like this and mail it out to their customers with a monthly mailing of their customers' statements.

Q It saves postage that way, I guess.

A Yes, do two things at once.

Q Did the examiners have any role in respect to these statements of financial condition that were prepared for the customers?

A Yes, we did. We received a copy of it and one of the functions of the examiners' department was to review it and reconcile it to the financial questionnaire to more or less establish that there was no discrepancy between the two.

Q Was that to insure that the customer got the

same information as the exchange?

A Yes.

Q Would you take a look at page Roman II, 51, which is a portion of schedule 11 of Exhibit Z. Do you see that page, Mr. McElroy?

A Yes, I do.

Q Now, I call your attention to the material in the center of that page, "Graduated income debentures due December 31, 1968, Series B," and the notation "Estate of James F. McDonnell, $318,623." Now, is that information reflected in the statement of financial condition, which is Exhibit J, going to customers?

A Yes, it is.

Q Can you point out where or describe how it is reflected?

A Well, in the statement of financial condition that was sent out to customers, in the right-hand side of the balance sheet you have a section entitled "Capital and subordinated liabilities," and under "Registered subordinated debentures," the second item states "Series B, graduated income due December 31, 1968," and it gives the total of $781,996, which agrees with the total shown on schedule 11.

MR. BEEBE: Excuse me. I believe there were copies of this yesterday for the jury. Shall we give it

back to them? I may have some questions on it, too.

MR. BROOKS: I don't think I have my copies arrang to give out right now.

THE COURT: All right. When it comes to that we will see what we should do.

Q I ask you to back up a little bit in Exhibit Z. Page Roman I, 10. Do you see that note there which, in substance, says that on December 31, 1968, the Series A debentures and the Series B debentures were rolled over except for $80,000 which was redeemed for cash, into a Series E debenture. Do you see a footnote saying in substance that, sir?

A Yes, I do.

Q Now, I ask you to look at the statement of financial condition and see if you see essentially the same footnote?

A Yes. The second note to the balance sheet I believe says approximately the same thing.

Q Now, yesterday Mr. Beebe asked you whether as an examiner you were checking the capital of the firm you would check the underlying documents in respect to debentures. Do you recall that question?

A Yes, I do.

Q Now, would you have checked in February of 1969

any underlying documents to ascertain whether the B debentures had been rolled over validly into E debentures in view of the attestation and note of Messrs. Lybrand, Ross Bros. & Montgomery, which you would have had as part of your working papers?

A I certainly would accept the statement of the public accountants as sufficient evidence to satisfy me that this roll over occurred.

Q You and those three men that were working with you had more things to do than check up on Lybrand Bros.?

MR. BEEBE: Objection.

THE COURT: Sustained.

Q Now we have talked about the audit. I take it it took quite some time to arrive at the report that was Exhibit Z. In fact it has a date on it. Can you tell me when Lybrand Ross signed off on Exhibit Z?

A Their opinion letter is dated January 12th of 1969.

Q Does that indicate that they were working from October 31st until January 12th on it?

A That's correct.

Q Take a look at Exhibit J. Is the date the same?

A It is the same. It has a little exception there. "Except as to the note to the statement of financial condition," with respect to which there is a date of

February 6, 1969.

Q Does that mean that this entire statement, except for these two notes, speaks or is reported on as of January 12th?

A That's right.

Q Except the notes which are speaking as of February 6th?

A That's right.

Q As a matter of practice why would the accountants put in notes that speak as of February 6th when this was a statement that's supposed to be speaking back in October of '68?

A Well, they had the responsibility of reporting changes that occurred while they were still on the premises.

Q And are those two notes such changes?

A Yes, I would say so.

Q Now, I believe you testified that starting some time in February you and Mr. Zaremba and Mr. Cummings were instructed by others of the stock change to make an examination of McDonnell & Co., that you three men spent from some time in February about through the end of March, maybe the first couple of days of April at the premises making your investigation?

A That's correct.

Q Except for some meetings that you might have attended at the exchanges. How does the examination that you three men conducted for that month and a half or so compare with the type of examination that these auditors did between October and January 12th?

A There is a distinction. I mentioned that the auditors would start theiraudit with 50 to 100 people because they are going to make a detailed verification of all the securities and cash, and so forth. We didn't have that capability and that wasn't part of our job. We were more involved with the assembly of the financial information into the report, but obviously we were not doing a complete verification such as the auditors would do.

Q Would the technique that you examiners used be described as a sampling technique in your practice?

A Well, even to some extent I guess you might say that the auditors did a sampling technique, but they actually were verifying everything. We just didn't have that capability. We would make test counts of security positions and that would be on a sample basis. We didn't verify cash in the banks by confirming with the banks. We knew the auditors did that. We usually would review bank reconciliations to make sure that they were being prepared. It certainly was more of a sampling.

Q We referred to the stock exchange rule 325 and I think it's clear by now that that's the rule that sets the capital requirements of the exchange, does it not?

A That's right.

Q Do you have the stock exchange rules for 1969 in front of you, sir, which I think is Exhibit 34?

A Yes, I do.

Q Can you tell me roughly, without counting, roughly how many pages in that exhibit, rule 325, covers?

A Under rule 325 --

MR. BEEBE: Objection. It just might be

quicker to let the document speak for itself.

THE COURT: Yes. Can you give us the number of pages?

THE WITNESS: 30 or 40 pages.

MR. BROOKS: I will accept that.

Q Now, you said that the 30-day rule governing collectability of assets or receivables before you could count it as good capital under the rule was not in the rule; is that correct?

A Yes, I believe I said that.

Q Now, who makes the judgment whether something is collectable in 30 days or something is not?

A Well, some things by their terms are collectable within 30 days in the normal course of business. For instance, we would always allow floor brokerage as a good asset because it was a practice that the floor brokers would settle up their bills about the middle of the following month. So that was an automatic thing that we would allow.

Q That judgment was based on practice, I suppose.

A Practice.

Q That's the way people usually do it.

A Yes. I know that while that may not be specified in the rules, it certainly was made known to

the membership through what we called MF circulars, member firms educational circulars. I know of one that was in existence at least as early as 1963 that directed the attention that this was the exchange policy.

Q And I take it for some particular kinds of assets you might have another piece of writing somewhere to supplement the rule and say that for these assets we are going to make the judgment this way; is that right?

MR. BEEBE: Objection, your Honor. I don't see how you can supplement rules that are required to be filed with the SEC if you don't file them with the SEC.

THE COURT: I will hear the question.

(Question read)

THE COURT: Sustain the objection to the question on the grounds of form, not the substance.

Q Mr. McElroy, as a matter of practice did the stock exchange from time to time put out writings such as a member firm circular to its membership to advise them how certain assets would be treated in respect to this 30-day rule?

A Yes, there are hundreds of MF circulars on

a variety of subjects and a number of them are directed to rule 325 and how to treat things in computing capital.

Q To whom were these circulars addressed?

A They are usually addressed to managing partners or chief financial officers, chief operating officers or all members and member firms, that type of address. And they are mailed out to all the member firms as they are issued.

Q And what was the purpose of these circulars?

A The purpose was to inform and instruct the stock exchange community of how to comply with rules, how to treat certain situations as they arose.

The industry is constantly changing, and as new situations arise --

MR. BEEBE: Objection. I think he is getting beyond the initial question.

MR. BROOKS: The question was the purpose of these circulars. I think he is still within the question, your Honor.

THE COURT: Read me back the answer.

(Answer read)

THE COURT: I sustain the objection.

Q Mr. McElroy, who would make the judgment

that became reflected in these circulars that would be sent out as to how a particular asset or a particular set of facts should or should not be treated under this 30-day practice?

A I believe it was a decision of the staff of the stock exchange, though the ultimate circular would go out over a signature of a department officer.

Q And do you recall who the department officer would be who would sign such a circular in and about 1969?

A Well, Mr. Bishop would probably sign most of those that we are talking about.

Q Did you ever come across or know of any of your fellow examiners coming across an asset or a particular set of facts that you didn't have a circular on to determine whether it was in or whether it was out of this 30-day rule?

A Oh, certainly.

Q And what would you do then?

A The examiners as a matter of practice would get in touch with the principal examinaer to whom they were reporting. and there was constant consultation. Questions would arise all the time and it would be resolved through discussion, of if necessary, seeking

advice of a higher authority.

Q Someone who had authority to make an interpretation of those particular assets?

A Yes.

Q Would I be right in assuming that the member firm would most likely be arguing that this asset was eligible for capital credit?

A Yes.

Q And would they enter into disputation with exchange officials and employees who thought to the contrary?

A Yes. There certainly were many discussions and arguments and opinions. That's the way it was and still is.

Q Was that particularly so in this time of the paperwork crunch?

A Well, we were faced with a lot of new situations that we hadn't run into before, so obviously we had many questions arising we hadn't seen before and had to seek advice from the exchange, had arguments with member firms.

Q Were there ever such arguments that went on amongst the ranks of the exchange?

A Definitely. Especially in the examiner's

department where I worked I know we had constant discussion about these matters.

Q And sometimes one group would take another position and another group of exchange employees or officers would take another, is that right?

A That's right.

Q Now, yesterday I think you gave an analysis of the capital rule and told us what it was designed to measure. I think you said that you started with net worth and then subtracted aggregate indebtedness, which was the total amount that the firm owed, and then you came up with net capital; is that right?

A No.

Q Please say it right.

A To determine net capital we would take net worth, as it's more or less generally defined, and deduct those assets which we felt were not readily convertible into cash. I don't know that I mentioned it the other day, but there are other deductions, too, to arrive at net capital.

For instance, the market value of a firm's securities which is included in net worth as a measure of valuing the liquidity, we would subtract a certain percentage of that market value also as a charge against

net capital. That's basically it.

Q After you make these subtractions from net worth you then subtract aggregate indebtedness?

A No. You relate the amount of net capital to the total of aggregate indebtedness and that's where your 20 to 1 ratio comes in. The aggregate indebtedness at that time should not have exceeded net capital by more than 20 times, which is also 2000 per cent.

Q I think you used the example yesterday that if you owed $20 million, you would need $1 million to be in compliance with the net capital requirement?

A That's right, yes.

Q Is this term, net capital, a creature solely of this exchange capital rule and parallel capital rules, whether they be of other exchanges or other regulatory institutions?

A Yes. I know of no other field in which it's used.

Q And I take it it's a somewhat artificial creature in that you couldn't expect anybody to conduct business if they owed 20 times more than they had, unless it were an artificial measurement?

MR. BEEBE: Objection, your Honor. It is leading and I think that it's getting into practically

areas of law.

THE COURT: This is getting down to something that's argumentative conclusion from the fact you established on the preceding question, is it not?

MR. BROOKS: Yes.

THE COURT: I sustain the objection.

Q You said that you would deduct from capital or net worth, as it is commonly thought of by the average businessman who runs a small business, you would deduct from that concept things that couldn't be sold in 30 days, like furniture, paintings on the wall and stock exchange seats: that wouldn't enter into your net capital formula, it would be taken out.

A That is correct.

Q That didn't mean, did it, that those could not be sold for cash to pay off a loan, did it?

A No, that didn't.

Q Sometimes assets such as those that would be deducted, like a stock exchange seat, would be substantial assets, would they not?

A Yes, that's correct.

Q From time to time to improve the capital ratio under this rule would exchange firms sell some of these assets, like stock exchange seats, and turn

something for which they couldn't get capital credit into cash, for which they could of course get credit?

A Yes, that's correct.

Q Now, I believe you testified yesterday that undre the capital rule, in the earlier days, and I'm not sure we were too precise, but sometime before or perhaps in the period we are talking about, the exchange would start to get concerned when the capital ratio of a firm would reach either 1500 or 1750 per cent; do you recall that?

A Yes, I do.

Q Was it first one of those per cents and then another under exchange practice?

A That's my recollection. I'm not 100 per cent sure about that, but my recollection is that first it was established at the 1700 or 1750 level and then it was later reduced to the 1500 level. That's the way I recall it.

Q Is this change an example of the evolving of the capital rule during this period?

MR. BEEBE: Objection, your Honor.

THE COURT: Sustained.

Q You testified yesterday that if a firm could demonstrate value for lettered stock it might be

considered as good capital, at least on a percentage, maybe 30 per cent, 50 per cent; is that right?

A I think that's correct. I know there is something in writing about it. I have read it somewheres in connection with the change in the Securities and Exchange Commission's own law also, that upon application to the governing authority capital credit can be allowed.

Q Now, I take it the manner of demonstrating value requires somebody to make a judgment as to whether value has been demonstrated, and if so how much value; is that correct?

A That's correct.

Q And at the New York Stock Exchange who was the person or authority who exercised that judgment to determine whether value was established and if so, how much value?

A Well, it would come through the department of member firms and it would undoubtedly be the head of that department, or at least he might delegate that to a key assistant. I don't know whether it was one specific person.

THE COURT: Mr. Brooks, are you going to be much longer?

MR. BROOKS: I think I will be.

THE COURT: Ladies and gentlemen, we will stand in recess until Monday morning. We will be in courtroom 619 and I understand Mr. Dorset has already given you directions as to where to go on Monday morning.

See you Monday morning. Over the weekend don't talk about this case with anyone. Continue to keep an open mind. Thank you very much.

(Adjourned to Monday, May 5, 1975, at 10 a.m.)

MARGARET MARY McDONNELL MURPHY, et al.
v.
McDONNELL & CO., INC., et al.

May 5, 1975,
10:00 A.M.

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A N D R E W R. M c E L R O Y, resumed.

CROSS EXAMINATION CONTINUED

BY MR. BROOKS:

Q Mr. McElroy, let me give you back Exhibit Z, which was the auditor's report to the stock exchange, and Exhibit J, which was the financial statement in part reflecting the results of the audit.

Now, you recall that we left off last Friday afternoon with the last question and answer essentially establishing that there was somebody at the exchange who made judgments about various assets being good capital and in what value. I want to ask you now, does Exhibit Z, when you get it, when the exchange receives it from the accountants, have on it a capital computation?

A No, it would not.

Q It would not?

A No.

Q Is there any reason that you know of why the auditors are not asked by exchange rule to furnish a capital computation when they submit their report?

A Well, they weren't at that time.

Q Is there any reason that you know of why they were not?

A No, I don't know the reason why not.

Q At that time --

A That's right.

Q -- who did the capital computation for a member firm?

A The capital computation was always prepared by the examiners department, section of the department of member firms.

Q And would they use data included in the auditor's report to do that computation?

A Yes. These financial questionnaires such as Exhibit D were in fact filed with the chief examiner and then would be assigned to someone on his staff for analysis to compute net capital. That net capital computation was double checked by a second examiner and then a third examiner would review it and summarize it.

Q Did the analysis of that capital computation have any particular name in exchange examiner's jargon?

A Well, we used to call the men who were doing the analysis, we would say they were working on the rock pile.

We had a constant flow of these questionnaires

coming in every month, and they would bring a new batch of them. Some of them would be the audited questionnaires, some would be those that were not audited. But we would handle them in a similar manner. They would come in to the chief examiner's office and be logged in and then assigned to people for analysis. It was a continual flow of work.

Q And would that analysis be written down anywhere?

A Yes. We had a specific style of work sheet on which we made these analyses.

Q Did that work sheet have any particular name in exchange examiner's jargon?

A Well, we would just refer to it as the analysis or capital computation.

Q Mr. McElroy, I show you what appears to be an accountant's or possibly an examiner's work sheet entitled "McDonnell & Co., Incorporated," dated October 31, 1968, and headed in the upper right "Reg Q." I ask you if that is the analysis on a work sheet which you have just referred to for McDonnell & Co.?

A What this particular work sheet is is a summary of our capital computation, and we call this a white sheet, the name coming from the fact that the analysis was done on yellow paper; this summary of it was done on white paper.

I had mentioned before that an examiner would analyze the questionnaire on the prescribed work sheet form. It would be double checked by another examiner. And this is the work sheet of the principal examiner who would review the work of the first two examiners and then summarize it on this sheet, from which it would be passed along to the finance department for followup.

Q This is a three-page document.

A This particular one is three pages, yes.

MR. BROOKS: I note that this was Plaintiffs' Deposition Exhibit 46 and I now offer it in evidence.

THE COURT: Any objection?

MR. BEEBE: One question on voir dire.

Who assigned this? It appears to be signed signed January 27, '69. I don't know if it is this witness' document.

THE WITNESS: I can identify the signature, I believe. That is the signature of a principal examiner by the name of Edward Carley.

MR. BEEBE: No objection to the offer, your Honor.

THE COURT: Very well.

(Defendant Stock Exchange Exhibit AA is received in evidence)

Q Mr. McElroy, could you find on Exhibit AA a capital ratio that Mr. Carley has computed?

A Yes. The ratio shown on this white sheet is 3,992 per cent.

Q Do you find a figure reflecting net worth computed by Mr. Carley?

A Yes. The net worth figure here is $16,610,810.

Q Now, what would happen to this white sheet after it was prepared by Mr. Carby in the practice of the exchange?

A Well, this white sheet was then sent to what we would call the Division of Finance, which would include the coordinator for McDonnell, and other men, who would follow up on any problems that were reflected in the analysis.

Q Would the capital ratio that is reflected on the white sheet be the final determination of the exchange as to what the ratio of McDonnell & Company was as of October 31, 1968?

A Well, it would be the final determination that the examiners made. From that point on it was more or less out of our hands.

Q Do you know whether that might be changed by other departments of the exchange as the white sheet got passed along?

A I would say that that's possible, yes.

Q Turning again to Exhibit Z, the auditor's report, Mr. McElroy, can you tell from that auditor's report what the date of a subordination agreement would be for a subordinated capital contributor to McDonnell & Company as of October 31, 1968?

A I should be able to, yes.

Q Let me suggest that schedule 13, page 1 might show that information.

A Schedule 13 is a schedule of cash and security borrowings which are unconditionally subordinated to all claims of general creditors. Then there is a schedule of different subordinations there which do show dates.

Q Do you see in that schedule an indication that Anna M. McDonnell is a subordinated lender to McDonnel & Company as of October 31, 1968?

A That's Anna Murphy McDonnell under agreement dated December 30, 1966?

Q Yes, that's the capital contributor I was referring to.

A Yes.

Q Is there any amount shown for Mrs. McDonnell's subordinated investment at October 31, '68?

A Yes. It reflects a ledger credit balance of $627 and non-exempt securities with a market value of

$555,546.

Q And to find out the total value of her investment would add those two figures together?

A Yes, that's right.

Q And do you understand from that indication on the report that Mrs. McDonnell's capital to the extent of the total of those two figures you have just read would be part of the capital of McDonnell & Company as of this date?

A Yes, I would.

Q Can you ascertain from that schedule what the termination date was of Mrs. McDonnell's subordination agreement?

A No, I can't.

Q Would you turn a few pages to page 3 of schedule 13 and see if there is any information which you would interpret responsive to that question.

A Yes. There is a note there which indicates, "Termination of the subordination agreements is effective at the option of either the respondent or the lender, but only on a date 100 days after the receipt of the written notice."

Q Mr. McElroy, you have also before you the pamphlet financial statement of McDonnell & Company as of the same date, October 31, '68, which we discussed on Friday.

I believe you testified that financial statements such as that would be received by the exchange and would be compared by examiners against Exhibit Z, the more formal report. How and where would Exhibit J arrive at the exchange?

A To the best of my knowledge it would be supplied to the exchange by the member firm itself.

Q And in what department of the exchange would it end up in ?

A It would end up in the examiner's department.

Q I show you a letter dated March 3, 1969, addressed to the Department of Member Firms, New York Stock Exchange, signed by Thomas A. McKay, and appearing to bear a stamp of the chief examiner. I ask you if you recognize that receipt stamp as one customarily applied by the office of the chief examiner at the time, that is March 1969, to incoming documents such as this letter?

A Yes, that's the chief examiner's stamp.

Q And is this letter that I have shown you the

kind of covering letter which would be sent to the examiner's department along with a statement of financial condition such as Exhibit J.

A Yes, this appears to be the transmittal letter which was filed submitting Exhibit J to the chief examiner.

MR. BROOKS: I offer the March 30, 1969 letter in evidence, your Honor.

MR. BEEBE: No objection.

(Defendant Stock Exchange Exhibit BB was received in evidence)

MR. BROOKS: Exhibit BB is five lines long and I would like to read it.

(Defenant Stock Exchange Exhibit BB was read to the jury)

Q Would Exhibit J be the statement that this letter is referring to?

A Yes, that's correct.

Q When we were getting your pedigree in the record, Mr. McElroy, you told us that you had worked for eight years for Haskins & Sells.

A That is correct.

Q And that you worked on a number of audits at brokerage firms, but I believe you disclaimed, at

least as a certainty, that you were a manager of any of those brokerage audits.

A Yes, that's right.

Q Can you tell me what the duty and function of any audit manager is on a brokerage firm audit for a firm such as Haskins & Sells or Lybrand, Ross Brothers?

A Well, he would generally be responsible for all of the manpower that's being used on the audit, and it would be his job to see, first of all, that they would be assigned to the security account, the control of securities in and out of the firm, the cash account, and so forth. Then he would overall direct the manpower that he had assigned to him throughout the audit, seeing that all of the audit functions prescribed by the stock exchange and also as established in the audit guide for brokers and dealers which was put out by the American Institute of Accounting were followed and durect the audit to conclusion.

Q Did the audit manager have a boss?

A Well, yes. All the auditors to report to a partner of the audit firm. The audit firms were always partnerships. In all cases there would be a partner of the firm who would be responsible for the

audit.

Q Would it be fair to say that the audit manager was sort of like the foreman of the job?

A That's a good analogy, yes.

Q Would the audit manager have overall knowledge of the progress and findings of the audit as it progressed from time to time?

A Yes, he would certainly be aware of anything that was going on in any particular area of the audit. Especially if there are any problems involved, why his assistants would report them to him at once.

Q Do you know who the audit manager was of the Lybrand, Ross Brothers & Montgomery audit of McDonnell & Company as of October 31, 1968?

A Well, I'm not sure. I have an idea, but I'm not 100 per cent sure.

MR. BEEBE: Objection if the witness doesn't have knowledge of this, personal knowledge.

THE COURT: Sustained.

Q Tell us what you do know of that situation.

A Well, there was a fellow that worked for Lybrand by the name of Dave Rome who had handled the McDonnell audit I think on several occasions, and I wasn't sure whether he had been on this audit initially.

I know he left and became the controller of McDonnell & Company.

Q Do you know whether he did that during the course of the audit?

A That is what I'm not sure about, at what point he left to become the controller.

Q Do you know whether Mr. Rome bought any stock in McDonnell & Company when he joined the firm?

A Yes, he did.

Q You testified at pages 629 and 631 of the trial transcript about a meeting that you attended at the stock exchange during the course of your examination of McDonnell & Company in February, March and April of 1969. I think the transcript is not altogether clear on when the dates of any meetings that you attended at the stock exchange were.

Can you tell me when the first such meeting that you would have attended occurred as a result of the work you were doing at McDonnell & Company?

A No, I'm afraid I don't remember the dates.

Q Well, we have seen a memorandum dated April 2, 1969, which is Plaintiffs' Exhibit 23 reporting on two separate meetings in RMD's office with principals of McDonnell & Company.

Can you, after reading this memorandu, fix the date of such meetings?

A Well, this memorandum refers to the date of April 2 for two separate meetings "were held today," it says. So that would fix it at April 2. I would say that's approximately the time I would recall, although I wasn't sure of the specific date.

Q When did you go into the firm to start your examination?

A I saw a date on one of the exhibits the other day. I believe it was February 19th, approximately that date.

Q Let me read to you from Exhibit 28 and perhaps that will refresh your recollection. That's your full blown examiner's report. It begins by saying, "A limited examination was made at McDonnell & Company, Incorporated during the period February 18, 1969."

A That would be my statement of the time period.

Q Now, do you recall on this examination how long it took you after you got to the firm and took a look around, to come to any conclusions about anything that you were there to conclude on?

A No. I certainly would have taken several weeks to reach any conclusions, I'm sure of that. I might have become aware of -- I'm sure I was aware there was some sort of problem there when I went there, but I couldn't pin down the length of time before I would come to any final conclusion. Certainly it would take me most of my visit to get down to final numbers, and so forth.

Q Was the financial information that was gathered by the exchange about member firms such as that which you reported in your April report and which they got from Lybrand, Ross Brothers and from other sources to your knowledge maintained in confidence by the New York Stock Exchange?

A Yes. I feel we were very careful not to allow any of this information to escape.

Q Was it ever explained to you why there was a practice of being careful not to let financial details of member firms conditions escape?

A I don't remember a specific briefing, but just the nature of our work would make it confidential.

Q Are you aware whether that kind of confidentiality is maintained by other regulatory organizations who review brokerage firms?

A I am sure that you would have a great deal of trouble getting any information out of any regulatory authority, with the exception, the only thing I can think of is that the Securities and Exchange Commission files, I think, a person could go in and look at part one of the questionnaire that was filed with them, and that's about the only thing I know of that would be open to the public.

Q That is a public record, I suppose, at the Securities and Exchange Commission?

A Yes.

Q But not parts two and three?

A Parts two and three I don't believe are available.

Q In your work as you went about visiting member firms, did you ever meet any SEC examiners visiting the

same member firm?

A Yes, I am sure I have. I don't remember specific cases.

Q I take it you are aware that the SEC did have examiners that did visit member firms?

A That's correct, yes.

Q If you would, Mr. McElroy, I would like you to take a look at Exhibits 22, 24A and 25.

22 is the outline report for your examiner's report. 24A is a handwritten memorandum with some computations, capital ratios. Also take a look at 25, which is a short report about McDonnell & Company.

My question to you is, were 22, 24A and 25, drafts or outlines or preliminary material which all became incorporated to the extent relevant in Exhibit 28, which is your full-blown report?

MR. BEEBE: Objection, your Honor. That is leading, and I think the documents speak for themselves as to what's incorporated and what's relevant in one document and the other document. I particularly object to the word "relevant."

THE COURT: Let me hear the question back.

(Question read)

THE COURT: I will sustain the objection as

to form.

Q Mr. McElroy, were Exhibits 22, 24A and 25, preliminary efforts by you which efforts serve as the basis and became incorporated in Exhibit 28, your full-blown report?

A 22, I would say, that is correct.

25 is a complementary report issued at the same time and is more or less a summary of the full-blown report.

24A, in looking at it, it would appear to me certainly contains some of the information that is in the report, but not having looked at the report in a good many years I am not really sure. I notice that the handwritten memorandum, which is 24A, talks about a conversation of April 17. And we are talking about net capital at March 27.

I'm not sure whether my report went into March 27 capital position. That is the reason I am hesitant on that one particular exhibit.

Q Do you know when you prepared Exhibit 22, which is the outline?

A I couldn't give you an exact date. The end of March, approximately, sir.

Q Do you know when you prepared Exhibit 24A,

which is your handwritten two-page memorandum?

A No, except to say that it would have to be April 17, or afterwards. Probably after April 17.

Q How do you know that, sir?

A Because of the reference to the phone conversation of April 17. So that it would have to be prepared on or after that date.

Q As a matter of practice, does your examiner's report on a visit reflect all of the pertinent findings which you as an examiner make during the course of your examination?

A Yes, sir.

Q And did you follow that practice when you prepared Exhibit 28?

A Yes, I did.

Q Take a look at Exhibit 28, Mr. McElroy. That contains, if my count is correct, five different capital ratios for McDonnell & Company.

Can you tell me whether they are all of the same date?

A I was going to say, it starts out with the October 31 ratio.

Q How many ratios do you compute for that date?

A There are two ratios shown. 3565, which

includes the charge for short security differences, and then 2512, which is the same ratio except amended not to include that charge for short circuit differences.

Q You have following that ratios for another date?

A Then we go to January 30 of 1969, and there is a capital computation which is prepared from the analysis of the January 30 financial questionnaire which reflects 3825, and then as of the same date, without the charge for short security differences, there is a ratio of 2981.

And then there are several, two subsequent capital positions, again for January 30 of 1969, based on other subsequent information from my findings.

Q Before this period of the paperwork crunch, Mr. McElroy, was it usual to have this many computations of capital ratios on one examiner's report?

A No, there would only be one.

Q What created the need for five computations of ratios in and about April of 1969?

A Well, what had happened is that we were running into problems we had never run into before, or had rarely run into before, because of the paperwork crunch. For instance, the number of short security

differences became -- well, it used to be there were practically none, there would be no short security differences. The auditors would be able to clean those up before they would complete the audit.

Now we were running into, in the case of the October audit, short security differences of $1,345,000. This was certainly something that we just hadn't been accustomed to finding, and so as we said, I think on Friday, there were differences of opinion as to how to treat these matters.

Q You said that the auditors had not been able to clean up the security differences.

A That's right.

Q Let's explore that a little more to try to make it clear exactly where securities difference comes from and what you do when you find one.

Could you tell us the answer to those questions?

A Well, we had -- I think I mentioned before -- two kinds, two classifications, of differences, long differences and short differences.

Long differences would occur when the accountants who were counting the securities established the fact that there was a security under the control of

the firm, but they couldn't identify to whom it belonged, so they had a security, they didn't know who it belonged to, but it was in the possession of the company.

The reverse would be where they had a customer -- it wouldn't have to be a customer, but that would be the most common situation -- a customer who was supposed to have a particular stock and when they went through their routine of counting and confirming securities at other locations they couldn't identify that this security existed in any of those locations, and that would be a short security difference.

We looked on those as more dangerous to the firm, because if they owed it to the customer and didn't have it they would have to go out and buy it and it would cost them money.

Now, when it comes to clearing up these differences --

Q Let me stop you just for a minute, Mr. McElroy.

A Yes.

Q Do I understand you correctly that the difference is discovered after the auditors count the securities and compare what they found with what the record shows they ought to find?

A That's correct. They would count or confirm -- count the securities that were on the broker's premises, or confirm those which were due them from some other source, and compare that to the records, and then they would also -- well, the record would reflect who owned those securities, whether they belonged to the broker's customer or some other broker that he owed them to.

When this comparison didn't jibe that's when we would say we had a difference.

Q As a matter of practice, would the auditors make a list of security differences?

A Yes.

Q What would they then set about to do with the list?

A Then, once having established that there were differences, they would work with the employees of the firm that they were auditing in an attempt to establish exactly what the situation was, and it could be any one of a number of things. It could be a question of an improper description, it might be that the customer owned common stock of a particular company and their records reflected that they held preferred, and it would be a question of establishing which was the

correct record and adjusting it.

That is a simple illustration.

Q As they went about this research process, would they eliminate from their list of differences some differences?

A Yes. As they were able to establish what corrections should be made the client would put the correction through on its records, bringing the records into line with the true situation.

This process would go on during the course of the audit, which I believe we mentioned was 45 days, plus the time of -- the additional time of any extensions so that whereas on the initial day of the audit, when the differences were established, they might be five or six million dollars, and by the time the audit was completed they would be reduced to whatever figures the auditors finally reported.

Q Through research?

A Through research. This was true at all audits and it probably was true before the paper work crunch, except there were fewer differences and they were much more easily resoleved.

Q What would happen to the list of differences that remained a t the end of the audit? Would anybody

continue the research on those differences?

A Definitely. When the auditors had finished, and their time ran out, and they had to make their report, if there were still unresolved differences the employees of the firm themselves, the brokerage firm, would continue to work to try to resolve these differences. That was at this time, at 1969, that would be a continuing ongoing situation in many firms.

Q Do you know whether McDonnell & Company continued to do research on securities differences that were reported at the end of the Lybrand audit?

A Yes, they did.

Q Were they doing that while you were on the premises?

A Yes, they were.

Q Were they reducing the list of differences?

A Yes, they were.

Q Are securities differences sometimes referred to as stock record differences?

A That's correct.

Q Is that term interchangeable?

A Yes, I believe you can interchange those terms.

Q You testified on the first day of your

examination by Mr. Beebe that you knew of one firm that developed serious trouble almost instantaneously when they attempted to convert from a manual or machine record keeping system to a computer record-keeping system.

Do you recall that testimony?

A Yes, I do.

Q Do you recall the name of that firm?

A Yes, I do. The name of the firm was Emmett Baker.

Q Are they still in business today, sir?

A No. They went into liquidation in December of 1969.

Q Do you know of any other firms that established or encountered severe problems when they tried to convert from either a manual or machine type record keeping system to a computer system in or about May, 1969, 1970?

A Yes. Converting was always difficult, and I think firms had problems of that nature at many periods of time. However, they were aggravated at this period of time because of the high volume of business, and I am sure there are quite a few firms that ran into the problem of conversion.

I know of firsthand experience of another firm that went out of business in 1970. That was Fewes, Schmelsky & Company. I wouldn't want to try to spell that. But they converted to a new computer service and ran into a lot of difficulties, and never properly resolved them.

Q Do you know the computer record system that McDonnell & Company was attempting to convert to at this time?

A The computer system that they were attempting to convert to, I don't know whether it had a name. It was being developed for McDonnell by a firm called Data Architects. I believe that is the name of the firm that was attempting to make this conversion.

Q When you say being developed, can you tell us

what you mean by that?

A Well, they weren't make the equipment. The equipment itself would be purchased from one of the normal equipment manufacturers, such as IBM, Burroughs, or Control Data, but the actual devising of the plan that the brokerage firm would use was being worked upon by the firm Data Architects. They would set up a program which the data processing people would follow in entering entries into the records of McDonnell & Company. I believe it was also involved with the communications equipment, trying to get quicker entry of the information into the computer service.

Q Do you recall the name of the computer system that Emmett Baker was attempting to convert to?

MR. BEEBE: Objection.

THE COURT: This gets pretty far afield.

Q I was trying to develop whether they were the same as McDonnell's or not?

A No.

THE COURT: There is your answer. Go ahead.

Q Do you know of any firms which had serious problems in their conversation and overcame them?

A Yes, I certainly can answer you that. Thomson McKinnon had a conversion problem several years prior to this. I don't know the exact year, but I would say

approximately 1965 or '66. And they are still around today and bigger and stronger than ever.

Q Any other firms have the same problem and still around today bigger and stronger than ever?

MR. BEEBE: Objection to relevance.

THE COURT: Yes.

MR. BROOKS: I will move along, your Honor.

Q Let's go through quickly, Mr. McElroy, the exhibits that Mr. Beebe introduced on Friday, beginning with number 20.

That I believe you identified as a comment letter from Lybrand, Ross to McDonnell & Company. Do you have that before you, sir?

A Yes, I do.

Q There is a capital ratio shown on that first page. Does that ratio speak as of any particular date?

A Yes. This ratio would be as of the audit date of October 31, 1968.

Q What's the date of Exhibit 20, sir?

A March 12, 1969.

Q Turn over to page 2. Does the comment letter of Lybrand provide any information as to whether the ratio that was given on page 1 for October 31, 1968, has been improved?

A Yes. It says "Subsequent to October 31, 1968, and through February 8, 1969, the corporation's capital was expanded by a net increase in subordinated borrowings by approximately $1,300,000 and a net increase in capital stock of approximately $1,600,000. It is our understanding that based upon these increases in capital and upon other steps taken to increase capital as calculated under the requirements of the exchange, officials of the exchange have indicated that they do not consider the corporation to be in violation of Rule 325."

Q Take a look at Exhibit J, which is the pamphlet and financial statement, Mr. McElroy. Tell me whether you can find essentially that same information which you have just read in a note in Exhibit J?

A Under note it says "subsequent" -- well, it says approximately the same thing. It discusses the increase of $1,300,000 resulting from the sale of additional shares of capital stock, and an increase in subordinated borrowings of $1,600,000 in order to provide capital as required under the regulations of the New York Stock Exchange. Based upon discussions with officials of the exchange as a result of these increases in capital and other steps the corporation currently meets the exchange's capital requirements."

So that is approximately the same.

Q Mr. McElroy, take a look at Exhibit 22 now, which is the outline for your report H. Do you see the first page there you computed a ratio for January 30th of 3,825 per cent under certain circumstances?

A Yes.

Q And there follows a computation as of the same date by Mr. Rome of 1,886 per cent?

A Yes.

Q Those are of the same date, are they not?

A That's correct.

Q How do you account for the difference between Mr. Rome's computation and your computation?

A Well, the differences are described in item 3. Substantially, there are three items which Mr. Rome's computation did not include as charges. One is the charge for unlocated shorts of $875,000, one is a charge for short dividends of $1,327,000, and the third item is a charge for tax claims of $700,000.

Q Take a look at the two notes down at the bottom of page 1, particularly note 2, which reads "Subject to discussion," an abbreviation I assume meaning McDonell" wants to have offset versus audit shorts diff."

Who did you mean when you wrote the note it would be subject to discussion with?

A With the exchange officials, I would presume.

MCD would be Murray McDonnell, or McDonnell & Company people.

Q You contemplated there would be discussions between exchange officials and McDonnell officials?

A That's right.

Q Did those discussions that you contemplated concern some treatment in the capital computation which was not altogether clear to you or McDonnell at this time?

A Yes. Where we are referring to long and short differences, and their desire to offset the two, long and short differences. Note 2 is referring to errors in computing longs and shorts in question 10.

Q Take a look at note 3 which reads "In part, subject to question of what's current and what does NYSE" and I assume that means the stock exchange -- "allow".

A Yes. That's right. That is referring to dividends.

Q I take it there was some doubt in the minds of both parties about that question when you wrote this note?

A Yes.

MR. BEEBE: Objection as to what was in other people's minds.

MR. BROOKS: One of the minds was Mr. McElroy's.

MR. BEEBE: That's okay.

THE COURT: Sustained on that ground.

Q Did you have some doubt when you wrote that note as to what the exchange does or does not allow?

A Yes, I am sure I did.

Q Were you discussing that subject with officials of the McDonnell & Company?

A That's correct.

Q Did they indicate to you that they had some doubt?

A Yes.

Q Look at Exhibit 24A, your handwritten notes referring to a phone conversation of April 17th, particularly the second page, the next to last paragraph, the last sentence, where it says--

A "Also, it is my belief that only an audit could disclose an accurate position."

Q What did you mean by that, sir?

A Well, my feeling was that sincewe did not do a 100 per cent check on everything that existed at the firm as of a given date we couldn't reach a 100 per cent definite conclusion. If you had an audit, as I described before, where all the securities are counted and all the cash is confirmed, the customers' accounts are confirmed, and so forth, a complete check on everything, you would establish more accurately what the true condition of the

firm was.

Q Is that true as a general proposition when an examiner makes a report?

A It certainly was at this time.

Q With other firms as well?

A Yes, not just with McDonnell.

Q Let's take a look at your final report, Exhibit 28, particularly page 6. Do you see that string of capital computations there, beginning with November 4, 1968, and ending on January 20, 1969?

A Yes, I do.

Q Whose computations are those?

A I will have to read this over for a minute.

(Pause)

A They are computations made by the firm.

Q Of McDonnell & Co.?

A Right.

Q When is the first time that McDonnell & Co. reports that its ratio exceeds the limit which we have discussed a few thousand per cent?

A That is January 13th of 1969.

Q Take a look at page 8, Mr. McElroy. The second paragraph in the section numbered 3, where it reads "The review of the books and records disclose that the records

are currently posted, with the exception of the transfer posting in the margin part."

What did you mean by the records being currently posted with that exception?

A What I meant was that there was no lag in getting the entries onto the books. In other words, at the end of the given day all the day's work was processed and put into the data processing system so that the following morning you would have the paper results of the previous day's business. I don't know whether that is clear, but during any given day in any kind of a business, why, you ar drawing checks and receiving cash in and making all kinds of entries. What I meant here was that that information was processed into the data processing system at the end of the day so that by the following morning it was into the books.

Q Take a look at page 10, paragraph 5. It says "The consulting firm of Leinhardt & Sullivan has been retained and is working on a review of the operations in the cage, in an effort to improve on the corporations' record keeping and operations."

Was that a personal observation that you made while you were there, sir?

A Yes. I remember talking to somebody from that firm.

Q Did you know of that firm?

A No, I had no knowledge of them, and I don't even recall now how I found out that they were there.

Q Did they have personnel there while you were there?

A Yes. I couldn't give you an estimate as to whether it was one or two or six, but I believe they were coming up from Philadelphia or Baltimore, or something like that. I don't remember exactly where.

Q Take a look at Exhibit 27, Mr. McElroy, page 2. That is the memorandum you identified as being a memorandum on the June 25, 1969, meeting between exchange officials and McDonnell & Co. officials.

A Dated June 25th, yes, all right.

Q Page 2.

A Page 2.

Q There is a list there of four steps that Mr. T. Murray McDonnell says have been taken or that he is prepared to take to increase capital. Do you see those, sir?

A Yes, I do.

Q Did you discuss any of those steps in the meeting?

A I can only say that I imagine so. I really don't recall. They are typical of the steps that would be taken at that time.

Q You mean the exchange had proposed or worked with other firms to handle similar problems by similar steps?

A That's right, yes.

Q On the top of the page 3 the memo reports that Mr. McDonnell was objecting to any restriction of the firm's rights business because that was a profitable business and had brought in over a million dollars so far in this year of 1969. Is that the conflict that you were referring to before in your testimony between restrictions and the need of the firm to maintain its profitability?

A This would be one example of it, yes.

Q Can you tell me what the competing values are involved in restrictions versus continuing profitability?

A Well, if you eliminate a profitable portion of

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a firm's operation, you are certainly going to hurt the firm in that profits improve capital. Lack of profits would have the opposite effect. But on the other hand, you have the problem of if you allow certain phases of the operation to continue you might, on the other hand, be aggravating record keeping problems or at least increasing capital requirements by the type of operation that you were engaged in.

For instance, in the rights business it involved the purchase of rights and this investment would result in a capital harge to the firm for haircut of securities. Haircut is our jargon for a penalty against capital for the ownership of securities. For instance, if a firm had $1,000,000 worth of common stock in its inventory, we would require, and data did require, that 30 per cent or $300,000 would be a charge against capital, if they had and sell those securities, there might be a decline in the market and they wouldn't realize the full $1,000,000. We had various schedules of haircuts depending on the type of security that was involved.

For instance, a U.S. government Treasury bill would generally have no haircut because it was so easily convertible to cash.

Q Who at the exchange made at this time these

judgments as to whether a particular restriction of the particular firm would help or would hurt that firm in respect to the problem you were working on with the firm?

MR. BEEBE: Objection. I don't see that as a judgmental matter of whether or not you enforce the rules.

MR. BROOKS: I don't think that is the question.

THE COURT: Overruled.

Q Can you answer that?

A There was a committee that we had mentioned earlier. The exact makeup of the committee, you know, was not my business to really know about. I don't think I could-- I would only guess if I were to try to mention names.

Q Do you know that the committee was composed of officers or employees of the exchange?

A It may have had officers of the exchange on it.

MR. BROOKS: I have no further questions.

THE COURT: All right.

MR. STEIN: I have no questions of this witness, your Honor.

MR. LOFLIN: I have no questions.

THE COURT: Redirect.

Q Sir, starting with the last area you were examined about, the question of whether or not competing values come into play when the issue of restrictions is raised, yesterday you testified that there was a series of proposed restrictions considered at one point. I think it was the April 2 meeting. Do you remember that?

A I think in one of those exhibits there was a list of such possible restrictions, yes.

Q One of them I asked you about was knowledgeability letters.

A Yes.

Q And how they fit into the restriction process. Based on your testimony just now, what competing value do knowledgeability letters receive or respond to?

MR. BROOKS: I believe the witness has testified that he did not have any firsthand knowledge of knowledgeability letters when Mr. Beebe asked him about it before.

MR. BEEBE: I am trying to probe a little deeper, your Honor, based on the testimony.

THE COURT: Overruled.

A What was the question again?

THE COURT: Read it back.

(Question read)

A Well, I'm not sure that I'll give you a good answer on that. When a firm is having any kind of financial difficulty, and perhaps not even if it's having financial difficulty, just if it wants to expand it would have to increase it's capital and it would go out and seek people who would be willing to make an investment in the firm.

Now, a knowledgeability letter was a letter which the prospective investor would have to sign indicating that he is aware of the financial condition of the firm in which he is going to put money and he still intends to put the money into it and he would not hold the stock exchange responsible.

Q But you are not able to tie it in any closer to restrictions?

A No. I wouldn't have necessarily put that as a restriction so much because it isn't a restriction on the firm's business. It's just an additional step that was taken at that time because of the firm's problems.

THE COURT: Are you going to be extensive with this redirect?

MR. BEEBE: Yes, reasonably.

THE COURT: We will take our recess now.

I want to canvass everybody at this point. This courtroom is apparently situated on or adjacent to the construction of some central air conditioning. You heard some noises on that. On the other hand, I don't want everybody to fall asleep because we have a stuffy courtroom.

Now, should we try having the windows opened and everybody try to work through some of the noises that we have heard from time to time, or shall we leave them closed and run the risk of somnolescence from time to time?

MR. BEEBE: I would vote for opening them.

THE COURT: Is that agreeable?

(The jury indicates in the affirmative.)

THE COURT: Very well. We will do that when we come back from recess.

(Recess)

(In open court; jury present)

BY MR. BEEBE:

Q Just before the recess we were talking about knowledgeability letters. As I recall, a knowledgeability letter is a document that the brokerage house obtains from someone who is a potential capital investor; is

that right?

A That is correct.

Q Is one effect of a knowledgeability letter to encourage the potential capital investor to look closely at the financial and other condition of the brokerage house?

MR. BROOKS: Object to the question.

THE COURT: Well, this calls for a matter of opinion.

MR. BEEBE: I believe he testified that's what the purpose of it was.

THE COURT: Well, then you have the answer.

MR. BROOKS: He testified he didn't have too much firsthand knowledge about these things either, your Honor.

THE COURT: Sustained.

Q Mr. McElroy, in your final report dated April 24, 1969, whether the short form or the long form, you gave certain figures for the net capital ratio, and as you said, the short form was a summary of the long form essentially, is that right?

A That's correct.

Q By that time -- let me pull back a little.

In your outline of report, which Mr. Brooks examined you about this morning, which is Exhibit 22, at this trial, you testified that some things were subject to discussion. I think you referred particularly to errors in reporting longs and shorts.

By the time you had reached your final report, had you made conclusions, final conclusions, at the examiner's level as to the -- you seem to be looking for an exhibit.

A Go on.

Q -- final determination at the examiner's level as to what the net capital ratio was based on different assumptions?

A That's correct.

Q As I remember from Friday's testimony, one of those figures -- and I am quoting from Exhibit 25, which is the short form report -- "After revision for

questionnaire errors and adjustments" was 5,525 per cent. Is that right?

A That's correct.

Q This morning Mr. Brooks asked you about conversions of record-keeping methods by using computers; and you mentioned two companies that you were aware of who had gone out of business after attempting to convert. One of them I think you asked not to be held to the pronunciation and I just did my best. I have down as Fewes, Schmelsky.

A That's as close as I come to it. That's right.

Q When did they make their attempt to convert? When did they start to attempt to convert?

A I am not sure of the date. Late 1968, early '69. Somewhere through there. I am guessing. I am not 100 per cent sure of that date.

Q After they made their attempt, did the exchange -- were you involved in their net capital computations after that time?

A No, I was not.

Q So you wouldn't have firsthand knowledge?

A No, my knowledge came at the time of their going out of business.

Q Then let's turn to Emmett Baker. When did they make their conversion attempt start?

A It was, I believe, at the end of October 1968.

Q And were you involved in the computations of their net capital after that date?

A No, I was not. I didn't go over there until late 1969.

Q You mentioned this morning the paperwork crunch, and you were talking in general terms about its effect on the industry. How many brokerage houses were in operation in the stock exchange in 1968-1969?

A Stock exchange member firms?

Q Yes, New York Stock Exchange member firms.

A The figure was over 600, I believe. 620, 630, something like that.

Q Were they all having the same kind of difficulties as extensive as McDonnell & Company?

MR. BROOKS: I object to the question, your Honor.

THE COURT: It's a little broad in form. Sustained.

Q Let me ask you this, Mr. McElroy. How many of those companies actually went out of business?

MR. BROOKS: I object to the question

unless Mr. Beebe tells us by when they went out of business, by day, or by the end of 1969.

MR. BEEBE: I was thinking in terms of as a result of the paper crunch.

MR. BROOKS: Then I object to the question on the ground he is asking for a conclusion. There is no foundation that he can draw it.

THE COURT: Can you?

THE WITNESS: I don't know the number.

Q You mentioned, I believe in the beginning of your testimony yesterday, that there were a number of firms that you were involved in the examination of during this period.

When you went into McDonnell & Company in February of 1969, was that the firm that you were particularly working on during that period from February to April?

A I worked on no other firm during that period.

Q One at a time?

A One at a time, yes.

Q This morning you said that, in the jargon of your group when people were examining the questionnaires they were known as being on the rock pile?

A That's right.

Q Did they examine the audited questionnaires?

A Yes. The procedure was the same whether it was audited or regular.

Q What were you looking for when you were examining either the audited or unaudited?

A We were making a capital computation from the figures that were submitted. That was our primary objective.

Q I see.

A And making notations such as would appear on Exhibit AA.

Q This was this three-page white sheet, I believe you called it?

A Yes, that's right. That was more or less the final product.

Q The finalwhat?

A The final product of our analysis.

Q This was the one that found that based on the Lybrand figures of October 31 the net capital computation was 3,992 per cent, is that right?

A That's correct.

Q This was in January of 1969, right?

A That's when it was prepared, I think. That's

correct.

Q You mentioned seeing SEC examiners sometimes when you were on your tours of duty.

Did you see any in McDonnell & Company between February and April of 1969?

A I don't remember seeing any.

Q With regard to the audit, do you have Exhibit S in front of you?

While you are looking for that, I would like to offer in evidence a document which is a letter and some attachments dated February 6, 1969, from Thomas McKay, McDonnell & Company, Inc., to Mr. Etro, of the division of finance in the New York Stock Exchange.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 10 was received in evidence)

Q Mr. McElroy, could you turn to schedule 13, page 1, that Mr. Brooks from the stock exchange was asking about this morning?

A Yes.

Q That shows on it, does it not, as of October 31, 1968, Anna McDonnell had roughly a half million dollars in a subordinated account at McDonnell & Company, is that correct?

A That is correct.

Q Turning to Exhibit 10, which was just marked, could I just read this and then ask a question about it? This is from McDonnell & Company to the stock exchange.

"We wish to advise that on January 30, 1969, Mrs. Anna M. McDonnell, subordinated lender under agreement dated December 30, 1966, and Mrs. Marjorie F. McDonnell, subordinated lender under agreement dated July 2, 1968, deposited additional securities into their subordinated accounts. The current securities deposited into each subordinated account are set forth in the attached schedules A and B."

Turning, if you will, to Schedule A --

MR. BROOKS: May I ask the date of the letter be read while Mr. Beebe is still on the first page.

THE COURT: Surely.

MR. BEEBE: It's February 6, 1969. I believe I had identified it.

Q Turning to Schedule A, if you will, sir, that is listed as the Anna M. McDonnell securities deposited on January 30, 1969. That totals $1,136,425.

When you take the amount that was in the

account, sir, on October 31, 1968, $555,546, and you add the amount that is deposited on January 30, 1969, $1,136,425, am I correct that as of that date Mrs. McDonnell's subordinated account in the firm was, without adding up precisely, in the neighborhood of $1,600,000? And I will make one assumption, that the October 30, 1969 account retained roughly the same value.

Is that right?

A Yes, that would be correct.

Q While we are in there, if you will turn to Exhibit S, the audit, will you please turn to footnote one, which is on page I-10, on which you were examined yesterday -- I would like to read the last part of that footnote one and ask you to tell the jury what it means:

"Although the amount of the losses, if any, which may be sustained as a result of the resolution of these matters cannot be determined at this time, the calculation of capital required by the rules of the New York Stock Exchange would require full provision for the unlocated securities ($1,345,868) and non-current dividends receivable ($872,491) reflected in question 13, and for the deficits ($1,049,862) in customers' accounts reflected in question 6C and D, were no credit being

given for the value of securities, $9,252,538, as to which ownership is not known; the result of such provision would be that the corporation would not meet the capital requirements of the New York Stock Exchange."

Could you tell the jury what that meant?

MR. BROOKS: I object to the question, your Honor. What it means is what it says. It's written by someone other than Mr. McElroy. The gentleman who wrote was deposed in this action. If Mr. Beebe wants to know anything further about what it says he ought to call the partner in charge.

THE COURT: It seems to me the exhibit speaks for itself.

MR. BEEBE: If I could understand that without reading it seven times I wouldn't feel compelled to ask the witness, who has been examined about this very document, to translate it into plain English.

THE COURT: He is not the author.

MR. BEEBE: He was examined about it and it is in his area of direct expertise. It's a document that he worked with extensively.

MR. BROOKS: Your Honor, he wasn't asked to interpret the language. He was asked to find a certain figure and tell us whether there was certain information reflected in this.

THE COURT: I sustain the objection.

Q Mr. McElroy, when you turn then to the covering report dated January 12, 1969, which is found at I-1, in the second paragraph after referring to security differences and a possible loss for unlocated securities there is a final sentence in that paragraph "McDonnell & Company, Incorporated, is continuing its efforts to determine the cause of differences in order to make appropriate adjustments. Reference is made also to note 1, with respect to the corporation's net capital as defined by the regulations of the New York Stock Exchange."

Note 1 was the one we just read. My question is: you were asked about clean certificates at one point in your cross-examination. Is this a "clean certificate"?

A I would say it is not.

Q Could you explain to the jury why, in what respect it is not clean?

A Because of the information which Mr. Beebe just read in the second paragraph. In the third paragraph the auditors state "Except for the effect of the resolution of the matters referred to in the preceding paragraph."

Q And "except for" language is very important, isn't it?

A That's right. It is an exception.

Q What was the nature of the exception they were carving out of the letter?

THE COURT: Isn't that in the letter?

MR. BEEBE: I don't think it is explained at all, your Honor, in the letter.

MR. BROOKS: I think it is or Messrs. Lybrand Ross Bros. are in trouble.

MR. BEEBE: That may be, your Honor.

A The letter says --

THE COURT: Wait a minute, Mr. McElroy. If you are just going to read the letter the letter is in evidence. If you are aware of something that goes beyond the letter that is part of the exception that is another matter.

Q What was the exception they were carving out?

THE COURT: The letter speaks for itself.

MR. BEEBE: May I read from the last paragraph, your Honor?

THE COURT: You may.

MR. BEEBE: Except for the effect that the resolution of the matters referred to in the preceding paragraph, the accompanying answers to financial questionnaires present fairly" -- and so on.

Q That was the exception, wasn't it?

A Yes.

Q Take Exhibit J for a moment. There was some testimony comparing Exhibit Z and J.

MR. BEEBE: Mr. Brooks, do you have the Exhibit Z you passed out to the jury? The other day.

MR. BROOKS: No, I don't. Mr. McElroy has the original.

Q You testified at page 720 and 721 on cross-examination last Friday -- "Well, Exhibit J is a means of informing the clients of the brokerage firm of the condition of the brokerage firm as of that given date."

And just before that you testified:

"Q Is the statement of financial condition" -- that is, Exhibit J -- "the product of the same audit?" -- Exhibit Z?

"A Yes.

"Q And it is rendered as of the same date?

"A As of the same date, right.

"Q And if I understand you correctly, the bottom line ought to be the same or there is a problem, is that correct?

"A That's correct. Yes, sir."

Is the report that is attached to Exhibit J, the bottom report by the auditors, a clean auditor's letter?

A After the date there it says "Except as to the notes to the statement of financial condition with respect to

which the date is February 6, 1969." And at the moment I don't know exactly what that is referring to. Without knowing that, I would have to say that that would appear to be some kind of an exception.

Q That's an exception as to date. Let's take that a little slowly, because I think that is just an exception as to the date. Let's see if we can clear that up.

MR. BROOKS: I object to counsel's comment.

THE COURT: Counsel's comments are not evidence, ladies and gentlemen. Disregard them.

Didn't we have some evidence on Friday as to whether Exhibit J was a clean opinion or not?

MR. BROOKS: I believe there was, and it seems to me Mr. McElroy said the same thing he did now except as to the deposition.

MR. BEEBE: That's what I am trying to straighten out.

THE COURT: Let's go ahead on the basis he has already said it is not a clean certification.

Q Mr. McElroy, does the word other than where it appears there in the date -- let me read that for you and the jury and see if I can ask you something about it. The bottom of the exhibit reads "New York, January 12, 1969. (except as to the note to the statement of financial

condition with respect to which the date is February 6,1969)"

Am I correct that the note is the note up here under the statement of financial condition, of which there are two footnotes? Isn't that what they are referring to, sir?

A It could be.

Q And what they are saying is that they updated the information up through February 6, 1969, that is in those footnotes, isn't that right?

A Yes, you could be right about that.

Q There is no exception, is there, in Exhibit J that is anything like the exception in Exhibit Z, which I just read to you "except for the effect of the resolution of matters referred to in the preceding paragraph".

A That's right.

Q Now, is there any reference in Exhibit J to the fact that in the January 12th report they had given an unclean letter?

A The note states "Based upon discussion with officials of the exchange as a result of these increases in capital, and of other steps taken, the corporation currently meets the exchange's capital requirements."

I think there is an inference there that without that they wouldn't meet capital requirements.

Q There is nothing clearly stated, you are saying,

but there is an inference, is that right?

A It is not as definite as in Exhibit Z, that's correct.

Q Your counsel introduced this morning a letter marked as Exhibit BB which appears to be a letter from McDonnell & Company to the exchange stating that exhibit--well, there is no attachment to it, but it says that a copy of the statement of financial condition as of October 31, 1968, was mailed to customers of our firm with their statement for the month of February, 1969."

Let's take this a step at a time and apply it to the three plaintiffs that we have here. Do you know of anything that the stock exchange sent out to customers or is it public or in any way disseminated, or that McDonnell & Company sent out or disseminated to its customers or the public, that conveyed the information, the essential information, that we have been talking about these past few days.

MR. BROOKS: I object.

THE COURT: Sustained as to form, if nothing else.

Q That conveyed the information contained in Exhibit Z to those people?

MR. BROOKS: I object again, your Honor.

THE COURT: He is just establishing the fact

whether he has any knowledge this was conveyed beyond the exchange.

MR. BEEBE: That's correct.

MR. BROOKS: It contains an assumption that the information contained in Exhibit Z was timely as of the date Exhibit J was sent out.

THE COURT: The question only goes to whether he has any knowledge that the information in Exhibit Z was conveyed to the public in any way. Overruled.

A No, I don't.

Q And that would be whether as of the date -- starting from the date that the exchange received it, according to the document in Exhibit Z, January 15, 1969, or shortly thereafter, up to today, isn't that right?

A I don't know that anything was disseminated.

Q Let's turn to J.

J, according to this Exhibit BB, was sent to the customers with their statements of February, 1969. When are the monthly statements sent out? Are they sent out toward the beginning of the following month?

A Approximately.

Q If there is a paper work delay or something it might be later than that, is that true?

A They could be delayed, yes.

Q In any case, they certainly went sent out before March 3, 1969, the date of this letter BB?

MR. BROOKS: I object to that. I think the inference is the other way.

THE COURT: Withdraw the question.

MR. BEEBE: I will withdraw the question.

Q You really personally don't know when they were sent out, do you?

A No, I don't.

Q One more question on note 1, sir, in the Exhibit Z, which is located at -- do you have it?

A Yes, at page I-10.

Q Let's take that long sentence I read you and ask some specific questions about it.

The first part says "Although the amount of the losses, if any, which may be sustained as a result of the resolution of these matters cannot be determined at this time" -- what losses were these referring to?

THE COURT: Is this the Lybrand report?

MR. BROOKS: This is the same one we went through.

THE COURT: I don't see how he can answer. This was not prepared by him, and asking for the interpretation of the language --

MR. BEEBE: Maybe I have confused it by going

to something. I am not asking questions for his interpretation. I am simply asking what the specific references are to so that the jury can follow it, because this man was examined extensively about this report, he did receive it, and I don't see the calling a Lybrand witness to explain this is really --

THE COURT: Mr. Beebe, doesn't this exhibit explain what the various references in it are to, because I do think to the extent an exhibit speaks for itself, and certainly where it is not prepared by the witness, I don't see why we should spend the time --

MR. BEEBE: Maybe I can shortcut it. I will ask one question to try to put the whole thing to rest.

Q This refers to, under the audit, of McDonnell & Company not meeting the capital requirements of Rule 325 of the exchange; is that right?

MR. BROOKS: I make the same objection, your Honor.

THE COURT: Let's see if we can't solve this. I will overrule it. Go ahead.

Q That's the subject of this note 1, isn't it, sir?

A Well, the last three lines make reference to it. It says "The results of such provision would be that the corporation would not meet the capital requirements of the New York Stock Exchange." That's what it says there.

MR. BROOKS: I think the answer illustrates the problem.

THE COURT: I agree.

MR. BROOKS: It can be seen from the exhibit itself.

Q Apart from the exhibit, was McDonnell's capital violations as of January, 1969, the result of something more than short record differences?

MR. BROOKS: I will object to the form of the question, your Honor.

THE COURT: Overruled.

Go ahead. Can you answer that?

THE WITNESS: Yes. I think that these various reports indicate that other things came into play besides stock record differences.

Q Stock record differences. Thank you, you corrected me.

A There are several points discussed and I would say that any one of them makes up a capital computation a charge for a stock record difference is only one part.

Q Others would be unlocated securities; is that right?

A That's the same thing.

Q Non-current dividends receivable?

A That's correct.

Q Deficits in customers' accounts?

A That's correct.

Q Securities as to which ownership is not known?

A No. We wouldn't charge capital for that.

Q Now, you testified that when the public accountants prepared their statement, their surprise audit it was sent to the exchange; is that right?

A That's correct.

Q Did the exchange look or the examiners department somewhere in the exchange, look at the audit to review it in any way, or did they accept it completely at face value?

A No, I think I have already testified that our

procedure was to analyze the information and compute capital from it.

Q That would be using it as a tool or a resource; is that right?

A That's right.

Q Did you also take everything that was stated in there on face value and accept it?

A Yes, I think we have to; yes.

Q Is there some rule that says you have to?

A I don't think there is a rule that says we have to, but it is supplied to us as accurate information. Until some subsequent event happens to prove that it is incorrect, we accept it as correct.

Q Have you ever found errors or heard of errors in auditor's statements?

A Yes.

Q They are only as good and accurate as the people involved, aren't they?

A I guess that's a fair statement.

Q You testified yesterday that the Rule 325 is 30 or 40 pages long and that it pertains to the net capital rule of the stock exchange. Is there also a Securities Exchange Act rule that governs -- are you familiar with the Securities Exchange Act rule that pertains to the net

capital ratios?

A I know there is such a rule, yes.

Q How long is that?

A I don't think it is as long as our rule.

Q It is rather short and straightforward, isn't it?

MR. BROOKS: I object.

THE COURT: How does this help us, Mr. Beebe, this comparison of length of a rule in one agency and in another?

MR. BEEBE: One governs the other.

THE COURT: I know. How does the length have anything to do with it?

MR. BEEBE: I couldn't figure that out on the initi " one. I want to correct the impression that length mea some difference.

THE COURT: I sustain the objection to that question.

MR. BEEBE: I just didn't want to leave an impression.

You testified late on Friday at page 733 as follows: "And sometimes one group," concerning the approach to the valuation of assets, "sometimes one group would take another position and another group of exchange employees or officers would take another; is that right?

"A That's right."

This morning you talked about competing values. Now, if a company that you are examining is in violation of net capital rules under your interpretation and the exchange, for whatever competing value is involved, does not want to put the company out of business, my question is what would the exchange do in interpreting the rules?

MR. BROOKS: Object to the question.

THE COURT: Sustained.

MR. BEEBE: No further questions on redirect, your Honor.

MR. BROOKS: Three quick ones, your Honor.

THE COURT: All right.

RECROSS EXAMINATION

BY MR. BROOKS:

Q Mr. McElroy, on redirect Mr. Beebe called your attention to Exhibit AA and to the capital ratio stated on that exhibit of 3,929 per cent. There is an alternative capital ratio given on that front page, is there not, sir?

A Yes, there is.

Q What is that ratio?

A 2,717 per cent.

Q What was the alternative set of facts which would make it 2,717 per cent--

THE COURT: Mr. Brooks, isn't that on the exhibit?

MR. BROOKS: I'm not sure. I will withdraw the question.

THE COURT: All right.

Q Mr. McElroy, would you take a look at the auditor's opinion on Exhibit Z, which is the long form auditor's report. I believe that is in and about Roman I-Arabic 1-2. Then the notes are on Roman I-10.

Now, do you see anything on Lybrand's opinion or report which speaks any later than January 12, 1969?

MR. BEEBE: Same objection, your Honor. The document speaks for itself.

THE COURT: Well, I take it this is a foundation question that will go on to something else.

Do you want to call his attention to where he can find this, if he is going to find it?

MR. BROOKS: I don't believe he will find it.

A I don't believe there is any other date.

Q Take a look at Exhibit J, sir. Do you see any information on Exhibit J which speaks of some events as late as February 6th?

A Yes. The note which I read before, except as to the note to the statement of the financial condition with respect to which the date is February 6, 1969.

Q Would you conclude from that that Exhibit J gives you more recent information about McDonnell & Company than Exhibit Z?

A Yes. Also the notes themselves speak of increases in equity capital through February 6, 1969.

Q Mr. Beebe asked you some questions, I believe, about the SEC capital rule. Does the stock exchange apply the SEC capital rule to its member firms, sir?

A No, it does not.

Q Do you know why it does not?

A Because we have our own rule and we are directed to apply our capital rule to our member firms.

Q Do you understand whether the SEC capital rule exempts member firms of the New York Stock Exchange from complying with the SECcapital rule?

A I believe that's correct.

Q Do you know why it does that?

A I believe that's the way the law is written.

MR. BROOKS: That will be all. Thank you, Mr. McElroy.

THE COURT: Mr. Beebe, any questions?

MR. BEEBE: Yes.

REDIRECT EXAMINATION

BY MR. BEEBE:

Q Isn't the rule actually written under the Securities Exchange Act that "The exchange can enter into an agreement to comply and to enforce, so far as within its power, compliance by its members with the provisions of the Securities Exchange Act" --

MR. BROOKS: I object. That's not the SEC capital rule that he is reading from. If he reads from the rule he will see what Mr. McElroy is talking about.

THE COURT: Sustained.

That's from section 6, isn't it?

MR. BROOKS: Yes, it is.

Q And under the section on the exemption from section 6, sir --

MR. BROOKS: Same objection, your Honor.

THE COURT: Mr. Beebe, how does this prove it is?

MR. BEEBE: It tries to clear up something that was just brought out. They are not exempt, sir.

MR. BROOKS: May we approach the bench?

THE COURT: Yes.

(At the side bar.)

THE COURT: One problem I have, Mr. Beebe, if you objected to Mr. Brooks asking those questions I would have sustained it. You let the door open. You then want to ride on the swing that you let be swung.

MR. BROOKS: The point I am objecting to is the SEC capital rule, and I think you can take judicial notice of that rule, 15C3, exempts from its application members of the national securities exchanges which have a more comprehensive capital rule. The rule goes on to say that the New York Stock Exchange is such an exchange.

Now, if Mr. Beebe were to read from the rule that Mr. McElroy was talking about, he would see the exemption I am talking about.

I object to Mr. Beebe reading from statutes to a lay witness before the jury where the statures are not involved in any of the prior examination of the witness. They are something other than what the witness testified about.

MR. BEEBE: What I was trying to clear up is exactly the point Mr. Brooks made, which is perfectly valid. I wish he did it with the witness and I wouldn't have had to bring up the questions.

THE COURT: If you objected to his questions we wouldn't have gotten into this at all.

MR. BEEBE: He asked them, sir. I find the problem is that the impression is left with the jury that if you are exempted you don't have to enforce or comply with at least as vigorous a rule. That's the whole point. Sure

you are exempted as long as your rule is more vigorous.

MR. BROOKS: It doesn't say vigorous. It says comprehensive.

THE COURT: The problem you have here is this man is not a lawyer, he is an accountant.

Let's see if we can't do this in some better way as and when we get to it, if necessary, in the charge or in something of that kind. This is a legal matter. I shall sustain the objection at this point.

(In open court.)

THE COURT: Anything further?

MR. BEEBE: Nothing further, your Honor.

THE COURT: All right, Mr. McElroy, you may step down.

(Witness excused.)

THE COURT: Is your next witness ready?

MR. BEEBE: Your Honor, I am ready to have either the next witness or have the Anna McDonnell deposition read.

THE COURT: If the next witness is waiting in the wings,we will call your next witness.

MR. BEEBE: I call Mr. Schuette.

H E R B E R T E. S C H U E T T E, called as a witness, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEETE:

Q Mr. Schuette, were you an employee of the New York Stock Exchange in 1968 and 1969?

A Yes, I was.

Q What was your position?

A I was an assistant director, Department of Member Firms. Eventually I was called the coordinator.

Q Can you give us a little background about yourself, sir? Were you graduated from Central High School in Sheboygan, Wisconsin, in June, 1945?

A That's correct.

Q And did you go into the service?

A I enlisted in the Marine Corps in February of 1943. I was discharged in April of 1945. I went to the University of Wisconsin from 1945 to 1950; graduated from the University of Wisconsin; I came to New York, went to work for Standard & Poor's in October of 1955, and remained employed there -- beg your pardon. October of 1949. I remained employed there at Standard & Poor's until May of 1956.

From May of 1956 to June of 1962 I was a part owner of a financial publishing house called OTC Publishing Company. From there I went to, in June of 1962, to Basic Economics Corporation in New York City. I was employed there for

approximately one year until August of 1963. In January, 1974, I started employment with the New York Stock Exchange.

Q 1964, sir?

A January, 1964.

Q Going back to when you were at the University of Wisconsin, did you major in institutional economics?

A That's correct.

Q Did you also attend night school at NYU?

A Yes, I went to New York University.

Q And did you receive a Master's in business administration?

A I received a Master's in business administration, correct.

Q Now, starting in 1964 at the New York Stock Exchange, did you start as an office inspector in the Division of Supervisory Standards?

A That's correct.

Q And what did you do between 1964 and 1968 at the New York Stock Exchange?

A I was an office inspector for approximately 10 months, at which time I was promoted to manager of the Division of Supervisory Standards. Some time subsequent to that, I do not recall the date, I was made an assistant director of the Department of Member Firms.

Q Are you appearing here pursuant to subpoena, sir?

A Yes, sir.

Q Starting with the middle of 1968 did you begin to perform the functions of what was later called coordinator

A The functions I performed that became eventually the coordinator, I began about the middle of 1968.

Q And what are those functions generally?

A Sort of provide an oversight over a group of member firms. I was assigned to firms with the alphabet M through P.

Q One of them was McDonnell & Company?

A That's correct.

Q Who are you presently employed by?

A I'm employed by the Mutual Benefit Life Insurance Company and I am loaned out to the wholly owned subsidiary of which I am an officer.

Q What do you do there?

A I am the director of compliance and I manage the operations.

Q Were the duties of coordinator, going back to your term in the New York Stock Exchange, in particular in 1968 and '69, were they outlined to you in a notice from the head of the member firms department, do you recall that?

A Yes, they were, approximately some time in January of 1969.

Q I would like to ask you if this is what they were:

"A major objective of the coordinator idea is to bring together a coordinator and his assistants all of the surveillance information reaching the exchange concerning their firms. Enforcement is the most important assignment of the coordinators. The coordinators are authorized to request all divisions to assist in enforcement."

Was that your function?

A That is correct.

Q And did you have examiners who went out in the field and reported back to you the facts they found?

A The exchange had examiners that went out in the field, yes.

Q Were they called financial cops?

A That's the first time I have heard that expression.

Q Well, in any case,was their function to gather the information and report back to you?

A Indirectly, yes.

Q And if the information proved to be of a certain nature did you also get involved in drawing up charges?

A On occasion, yes.

Q What would be the occasion when you would draw up charges?

A Some violation of New York Stock Exchange rules, potential or possible violations of rules.

Q You drew up charges even when the exchange's rules were even only potentially violated; is that what you are saying?

A A decision had to be made whether a rule was actually violated or not. All the inspectors or

examiners could do is determine whether a potential violation existed.

Q Had youhad occasion in the past month or so to converse with anyone on the exchange, who is presently still employed by the exchange, concerning the subjects of your employment there in connection with this trial?

A No, I have not.

Q Did you receive the white sheets that the examiners drew up?

A No, I did not.

Q Were they sent to the finance specialist?

A That's correct.

Q What did the finance specialist do with them?

A He analyzed them and upon the basis of his analysis he would tell me what he figured he found.

Q Was Mr. Spies the finance specialist involved at McDonnell & Company?

A Yes.

Q Did he notify you of any unusual items? Is that his purpose?

A Yes.

Q And did you in turn, in the chain of command,

notify higher ups if there was something highly unusual?

A Yes.

Q When did you first get involved with McDonnell & Company?

A Approximately June of 1968.

Q Did it come to your attention at that time that McDonnell & Company had problems?

A Yes.

Q What were the problems as of June 1968?

A Customary problems that were extant on the street at that time, fails problems, failure to resolve differences, stock record differences, and so forth.

Q You say customary problems?

A At that point in time, yes.

Q Was McDonnell & Company involved in computer conversion at that point?

A They were.

Q Was that a customary thing to be involved with then?

A I wouldn't call that customary.

Q Were they having a problem with the computer conversion?

A They apparently were, yes.

Q That wasn't customary, was it?

A That's very difficult to answer that. During that paperwork crisis many firms were changing over to computer bookkeeping.

Q Let me ask you this: Had McDonnell & Company been on restrictions shortly before you got involved with them?

A Yes, they were.

Q In April 1968?

A That's the way I recall it, yes.

Q And you studied the files when you came on board?

A Yes, I did.

Q And what was the basis for htem being put on restrictions in April 1968?

A The fails and operating problems.

Q What is the basis for putting a firm on restriction?

A Their inability to adequately handle the business.

Q And does that only take place, that is, only put on restrictions when their problem is more than the customary one?

A Yes.

Q How long were they placed on restrictions?

A According to my recollection, a very short time. Several weeks.

Q What was the basis of the restrictions being removed?

A I have no idea.

Q In any case, starting in June 1968 did you review McDonnell & Company's operation problems fairly constantly and report at the regular coordinator meetings?

A I did.

Q And did they appear to be growing rather than receding?

A To the best of my recollection they were receding for a period in there and then they started to get worse again.

Q We are still talking about 1968?

A 1968.

Q And they began deteriorating more substantially towards the end of 1968; is that right?

MR. BROOKS: I object. He is leading the witness.

THE COURT: Sustained as to form.

Q Well, you said, and let me get the time frame right. I believe you said at first they were receding and then they were growing again?

A That is correct.

Q When did they start growing again?

A I don't recall the exact dates.

Q Was it still in '68?

A Sometime in the latter part of '68, yes.

Q What was done when they grew worse, at your post? Was anything done about the problems,or in reaction to the problems?

A Will you explain the nature of the question, please?

THE COURT: Put it again.

Q Let me pull back a little and approach it with some more testimony out first.

Was McDonnell & Company required to submit monthly special operating questionnaires at your suggestion at that time?

A Yes, they were.

Q Are monthly special operating questionnaires something a little bit more than is the customary requirement for brokerage houses reporting to the exchange?

A That is correct.

Q Whatwas your reason for requiring them to put the monthly SOQ's? What was your reason for requiring them to submit them?

A The reports they were sending in had shown an operating problem or problems.

Q Could you elucidate for the jury what the nature of the operating problems that were visible at that point were?

A Their apparent inability to handle all the transactions that the firm was making. The fails problems were growing. They had not yet had a chance to count the box. A few such problems.

Q Those are two that come to mind right now.

A Yes. Also they were converting over to the new computer system.

Q Could you explain to the jury the importance of a box count?

A The box is a terminology which --

MR. BROOKS: I object to the question, your Honor. I am not sure what importance is related to it. I think we need some more foundation before we talk about importance.

MR. BEEBE: I will take out the word "importance."

A The box contains all the securities, certificates owned by customers or to be delivered or received in. This periodically needs to be counted to make sure

that securities owed to customers are present.

Q And when was the last box count at McDonnell & Company before June of '68, sir?

A I believe it was October of '67.

Q When a firm was placed on monthly SOQ's and is required to submit these monthly questionnaires, did you report to higherups on a regular basis what the results of those questionnaires showed?

A Yes.

Q What did they show about McDonnell & Company in the months of July, August, September, October, November, December, 1968?

A As I indicated earlier, my recollection seemed to show that they were showing gradual improvements in their overall fails positions. Although they were having trouble getting their computers converted.

Q And they weren't counting the box, were they?

A No, they weren't.

Q Did there come a point when you recommended imposing restrictions on McDonnell & Company to get them to improve operations?

A Yes.

Q When was that?

A I don't recall the exact date.

Q Sometime late 1968?

A Probably late 1968, early 1969.

Q Sir, could you speak up a little just for the benefit of the jury?

A Yes, I will.

Q Some of this is new area, I think.

Now, you recommended imposing restrictions. What was the basis of your recommendation?

A Specifically I don't recall. Just a general overall picture.

Q Who did you recommend it to?

A I believe probably the earliest recommendations were made to Mr. Bishop.

Q This would be early in that period of June to December 1968?

A I would say late in '68.

Q When you said the earliest recommendations , you mean there were a series of recommendations by yourself?

A No. The firm was already under self imposed restrictions during that period.

Q Sir, what makes you say they were under self imposed restirctions in 1968?

A They filed a list of the restrictions that

they imposed upon the firm's operations.

Q Do you have a copy of that here? Have you seen such a document recently?

A I have seen such a document, yes.

Q When did you see that, sir?

A Oh, within the last week.

Q And this is 1968, these self imposed restrictions?

A Yes.

Q Could you describe it for us?

A They limited the number of transactions they would handle. I don't recall the specifics of it.

Q Are you sure it could have been late in January 1969 of that list you are talking about?

A These restrictions were imposed before I became the coordinator. They were self imposed, voluntary restrictions.

Q But you recommended on top of that that the exchange impose restrictions; is that right?

A Yes.

Q Is that because the self imposed restrictions weren't working?

A You are asking me to conclude whether they were working or not? I don't know.

Q I am asking that, sir.

THE COURT: His answer is I don't know. On that note we will recess for lunch.

2 o'clock, ladies and gentlemen.

Counsel will stay for a minute.

(Jury leaves courtroom)

THE COURT: Three things, gentlemen.

First, Mr. Beebe, what is your schedule here, because I think we should get this Anna McDonnell deposition completed at some point and I do not want, on the other hand, to have people backed up in the witness room.

What is your estimate with this gentleman?

MR. BEEBE: My estimate with Mr. Schuette I think we will be through tomorrow on direct. That will be it on direct.

THE COURT: And you have how many witnesses to follow?

MR. BEEBE: My thought as far as holding witnesses, sir, is t hat I fully agree with not holding them in a witness room, if at all possible. So I would suggest, since the cross seems to sometimes go on, that as soon as cross starts we alert the exchange witnesses. If Mr. Brooks is willing to do that, I think that is

perhaps the best procedure and not have them have to sit here for unknown lengths of time.

THE COURT: Why don't we do this: When Mr. Schuette is finished we will start reading Anna McDonnell and at that point we can give the next exchange witness a phone call, assuming he is under your control at this point.

MR. BROOKS: I have agreed to liaison with the witnesses but I would like to know who they are.

THE COURT: Now, this applies to all counsel. I think it would be appropriate to the extent that matters that are evidentiary and are contained in records, we could probably chop a third of the time off this trial by marking the records and going on. Everybody has gotten in the hatir here of asking the witness how certain language strikes him, what it means to him and asking him to compare one exhibit with another exhibit.

Nobody has been objecting to it. You are all very courteous counsel to each other, but I would think that to the extent this can be avoided we would turn what looks like a four-weeks trial into what should be a two-weeks trial.

You still have a number of witnesses to go, I understand, Mr. Beebe. If each one of these men go a day and a half or two days, you will use that time.

MR. BEEBE: Mr. Schuette will be one of the longer witnesses. Mr. McElroy was much longer on cross than I had anticipated.

THE COURT: Please let's start doing that. I am going to start applying some Section 6 limitations here. If things are already in the record or if they are in a document, avoiding having the witness comment on the document or make comparisons. You can save those things for an appropriate time, should that become necessary.

The third thing, Mr. Stein, you want to absent yourself from the courtroom starting later this week, as I understand it.

MR. STEIN: I would start it immediately, because I understand that the next two witnesses in this case are going to be exchange witneses. It's not that the receiver is uninterested or disinterested in these proceedings, your Honor. I think it's a very practical kind of decision, and I will remain in touch with the court on an hourly basis. I will have present in the courtroom Miss Fields, who is a legal

assistant employed by my office. She is not admitted to the bar. If your Honor would prefer, I could have her sit in the back of the room.

THE COURT: No, I think she should stay at counsel table.

Let me ask you this: Have you conferred with your client?

MR. STEIN: This emanates from my client.

THE COURT: Your client wants to exclude you from the courtroom?

MR. STEIN: Yes.

THE COURT: On that basis and that basis only I am going to permit you to do it. Whatever happens happens as far as your client is concerned.

If there is a certain area where you are needed and you don't make it in time, we won't be waiting for you.

MR. STEIN: Your Honor, that's a risk I fully understand and accept.

THE COURT: All right.

(Luncheon recess)

AFTERNOON SESSION
2:00 p.m.

(In open court; jury present)

H E R M A N C. S C H U E T T E resumed.

DIRECT EXAMINATION CONTINUED

BY MR. BEEBE:

Q Mr. Schuette, before lunch we were talking about your recommendation of restrictions in 1968, and the fact that the firm had been on restrictions for a short period in April 1968, and was then taken off.

At that point in time was a firm on restrictions permitted to expand?

A Generally not.

Q If a firm on restrictions desired to expand, would you be the person that they would come to for approval?

A The question would be raised with me, yes.

Q Did McDonnell & Company seek to expand by opening a new branch office early in May 1968?

A From the record, I recall, yes.

Q Was that almost immediately after their restrictions had been lifted?

A Apparently.

Q Was that request granted? Were they

permitted to expand?

A I don't recall.

Q You said this morning thatyou had recommended that restrictions be imposed. Were they imposed in 1968?

A No, not in 1968.

Q Do you know of any steps taken in 1968 by the exchange in reaction to the condition at McDonnell & Company?

A No steps any more than usual. No other steps than what were taken in a situation such as that.

Q Precisely what steps did the exchange take in 1968 to impose restrictions or do anything along those lines about the McDonnell & Company situation?

A The firm was put on a special list to be watched along with many others.

Q They were watched?

A Right.

Q Was anything done beyond watching, that's what I am asking.

A To the best of my knowledge, no.

Q Was it apparent by June 1968 that McDonnell & Company was a troubled firm?

MR. BROOKS: I object tothe question.

THE COURT: Yes, sustained.

Q When the special operations questionnaires were sent by the company to the stock exchange, was it your job to -- was it part of your job to review them?

A Yes, it was.

Q I show you a letter from McDonnell & Company to the department of member firms, the vice president, dated November 14, 1968, and ask you if you remember reviewing that document.

A I don't recall specifically reviewing this document.

Q Was that the type of document, the type of letter, that was sent with the SOQ's to describe what was in the SOQ's?

A Most special operations questionnaires did not have an accompaning letter, those that I received.

MR. BEEBE: I offer this as the next exhibit for plaintiffs.

MR. BROOKS: I object to the exhibit coming in on the foundation that has been laid.

THE COURT: Yes, sustained.

(Plaintiffs' Exhibit 30 was marked for identification)

MR. BEEBE: Maybe we will come back to that.

Q Did you continue to gather information on McDonnell & Company in the fall of 1968, and make notes on the information you were receiving, notes on the basis of the information you were receiving?

A On some of the material I also kept a record.

Q Did you prepare at one point a chronological listing of the events that occurred when you were a coordinator there?

A I probably prepared several.

Q I show you a document dated October 28, 1968, headed "McDonnell & Company," which consists of seven handwritten pages, and ask if that is in your handwriting.

A Sorry, did you ask a question?

Q I am asking, is that in your handwriting?

A That is my handwriting, yes, sir.

MR. BEEBE: I offer that in evidence.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 33A was received in evidence)

Q Does that document represent a chronology of events at McDonnell & Company between March 18, 1968 and --

A It does.

Q -- November 30, 1968?

No, I am sorry, the last date I think is October 14, 1968, is that right?

A Yes, that's correct.

Q What is the purpose of this document?

MR. BROOKS: Your Honor, Mr. Schuette has identified the memorandum. There is attached to it a chart. I wonder if we could have an identification of that as well. There are two charts. I would like to proceed with that as part of the exhibit.

MR. BEEBE: Could I get to that as I go through my examination, your Honor, or on cross, if necessary?

THE COURT: Is this a part of this exhibit?

MR. BEEBE: As offered and received, yes.

THE COURT: Are these an annexation to these notes or do they just happen to be stapled together, that's my question.

MR. BEEBE: As best I know they were produced stapled together, but if counsel has a voir dire I have no objection.

THE COURT: Go ahead, Mr. Brooks.

MR. BROOKS: I just thought it might be

proper to identify it as some of the handwriting which appears to be somewhat different from some of the other handwriting.

THE COURT: Now the question is raised, are they properly together, all of these sheets?

MR. BROOKS: I don't know.

THE COURT: Let's find out.

Mr. Schuette, how about it? Look at the last two pages.

THE WITNESS: I probably prepared the summarization from these summaries and special operations questionnaire summaries, although they probably were not part of this summarization.

Q Did you use the last two as bases for the summarization on top?

A Probably, yes.

Q On the first page of Exhibit 33A there are some initials which may be familiar to you. What do the top two initials stand for?

A I don't recall what the OO stands for.

Q I believe it was OQ.

A Operations questionnaire, with my initials.

Q And below that is your initials in your handwriting?

A Yes.

Q Was it your habit to initial things you received?

A I initialled these in that corner to indicate to my assistant it goes into the particular firm's file.

Q After you received or created a document like this?

A Yes.

Q Starting with the first page, what does it mean -- I will pull that back again.

When a firm is unable to state its stock record differences due to a lack of count of the box, as you described this morning, does that have an impact on the net capital ratio?

A Yes.

Q What is the impact?

A I would ask you to repeat that question.

Q What is the impact of the inability to count the box on the net capital ratio?

A It depends upon what the results of the count are. It may have some, it may have none.

Q Does the inability to count the box have some impact on the ratio?

MR. BROOKS: I object, your Honor. He asked

it and he answered it. It depends on what the count would be.

THE COURT: That's right.

BY MR. BEEBE:

Q I am talking about the case where you can't make a count.

MR. BROOKS: I believe he answered that question.

MR. BEEBE: I don't know what the answer is.

THE COURT: Answer it again.

A The fact that you are not counting the box doesn't mean it has any effect on the capital position at all. It's when there are differences in the count.

Q In other words, if you can't count the box you can't compute the capital, isn't that correct?

A That is substantially correct, yes, sir.

Q There is reference in this chronology on page 2 to the restrictions being lifted on April 19, 1968, and sub part D says progress and problems in conversion, and sub part B below that has three asterisks next to it, and it says "Restrictions might be reimposed if your operations fall behind or progress on resolving your backlog diminishes."

Now,had progress in resolving the backlog

at McDonnell & Company diminished by the time of this chronology, which was October 28?

A As I indicated, there was to the best of my recollection an improvement in the backlog of resolution of differences.

Q At first?

A For a while, yes, sir. And then it turned around.

Q Did you put the three asterisks next to that?

A Yes.

Q Whatwas your reason for doing so?

A Because this was taken from a letter I believe Mr. Bishop wrote to Mr. McDonnell.

Q I don't follow why you put three asterisks?

A For my information, probably.

Q Did you underline the words "Or progress on resolving your backlog diminishes"?

A I don't know.

Q Whatwas the reaction -- no, who did you recommend that the restrictions be -- who did you make your recommendations to when you recommended that restrictions be imposed?

A Initially, the coordinators work directly under Mr. Bishop, and the recommendation would have been

to him. Eventually, the coordinator reporting was to be made to either Mr. Bishop or Mr. Stock.

Q And what was their reaction when you made these recommendations to them in late 1968?

A You are asking me to categorize how they reacted?

Q No, I am asking you to explain to the jury precisely what they said when you recommended making our imposing restrictions?

A I don't recall precisely what they said.

Q Can you recall in essence for the jury what it was they told you when you made these recommendations?

A I don't recall what they may have told me.

Q I am not asking you what they might have told you. I am saying, did they agree with you.

MR. BROOKS: Your Honor, this is the second time.

THE COURT: Yes, sustained.

Q You can't give us anything of what they said in reaction toyour recommendations?

A Based on by what followed, probably the answer was--

MR. BROOKS: Your Honor, I move to strike the answer as to what it probably was on the basis.

THE COURT: Yes. Do you have a memory of what each man said in substance, words, or any other manner?

THE WITNESS: No, I do not, your Honor.

THE COURT: All right, go on.

Q Did you have in the files, the OQ files, a

document known as an operations check list?

A (No reponse)

Q Does that ring a bell?

A It does not ring a bell.

Q Let me show you a document we marked previously as 34A for identification.(handing to witness).

I ask if you ever have seen that before. I direct your attention, if you turn it over, to the initials in the upper left-hand corner, CQ, and what appears to be below that your initials.

A Yes, they are my initials, and this is the form we knew as the special operations questionnaire.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: Your Honor --

MR. BEEBE: I note it appears to be dated 11/4/68.

MR. BROOKS: Your Honor, I have some problem with this document because the first page is entitled "Securities and Exchange Commission Regional Office." I believe it is being offered as a New York Stock Exchange exhibit, or a document of the exchange.

THE COURT: Why don't you ask on the voir dire of this witness what his association with this exhibit is.

VOIR DIRE EXAMINATION

BY MR. BROOKS:

Q Mr. Schuette, do you see the heading on the document I have just referred to?

A Yes, I do.

Q Can you tell me how you come to be acquainted with a document entitled Securities and Exchange Commission Regional Office?

A I can't tell you how I got ahold of it, or how it got into my files.

Q Other than your initials -- by the way, where did you say your initials appear?

(Pause)

Never mind, I found it.

Could this be a document prepared by someone at the Securities and Exchange Commission which reached your files?

A Yes, it could be.

MR. BROOKS: I object, your Honor.

THE COURT: Unless the witness has further familiarity with it I sustain the objection.

BY MR. BEEBE:

Q How did it get into your files?

A I beg your pardon?

Q Do you know how it got into your files?

A We had arrangements with the other regulatory bodies to exchange data and information about the firms.

Q And did you receive it on or about the date indicated on the first page, November 4, 1968?

A I don't recall.

Q Do you recall what you did with this information after you received it?

A I do not.

Q Did you just -- you don't recall anything about the document?

A I don't recall. I don't recall anything about the document.

MR. BROOKS: Your Honor, I would have no objection to the admission of this document as a Securities and Exchange Commission document. I think it was offered as a New York Stock Exchange document, to which I objected.

MR. BEEBE: It is offered as a document in the New York Stock Exchange files showing what information the New York Stock Exchange had about McDonnell & Co.

THE COURT: There is no date, is there?

MR. BEEBE: Excuse me?

THE COURT: There is no showing as to when it was received.

MR. BROOKS: That's correct.

THE COURT: On this record.

MR. BEEBE: I can't add anything to when it was received.

MR. BROOKS: There is an attachment on the last page, which is the last page, your Honor, which appears to be a memorandum from one Securities and Exchange Commission office to another which bears a date stamp of June 14, 1968, but I don't think that document is really part of the other document. I think it is really a memorandu which probably caused the Securities and Exchange Commission to undertake such investigations as reflected in Exhibit 34A. Other than that, I don't think there is a date.

THE COURT: Would you object to it on the ground there is no showing when your client received it?

MR. BROOKS: No, I think there has been a showing at one time Mr. Schuette did put the initials on the page. When that was we don't know. It could have been in 1969.

THE COURT: All right. On that basis it will be received in evidence.

Q Let me ask one more question on the date, sir. On the first page in handwriting on the right-hand side is the date 11/4/68. Is that your handwriting?

A It is not.

(Plaintiffs' Exhibit 34A received in evidence.)

Q Did you and other employees in the member firm department exchange information about McDonnell & Company during 1968, keep each other abreast of what you were learning?

A Yes, we did.

Q Did there come a time when you received a note from a Mr. Bishop concerning McDonnell & Company? I hand you a document we previously marked 35A for identification, and ask you if that typewritten note dated November 7, 1968, was received by you on or about that date?

A I don't recall.

Q Are you HES?

A That's correct.

Q And the bottom of the page has what appears to be a note going back to RMB. Does that have your initials at the end of it?

A That's correct.

Q Amd the bottom says "The attached summaries will show" and so on. If I could ask you to turn the page, sir, are those attached summaries, were they prepared by you?

A They were, yes, sir.

MR. BEEBE: I offer that as the plaintiffs' next exhibit.

MR. BROOKS: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 35A received in evidence.)

Q I would like to read this memo which appears to be your reply. RMB is Robert M. Bishop, is that correct?

A That's correct.

Q What was his position at the Department of Member Firms at the time?

A He was the vice president and director of the Department of Member Firms.

Q Who was the president, or was there one?

A There was none.

Q So he was the head of that department?

A Yes.

Q He in turn reported to whom?

A He reported to Mr. Arning or Mr. Cunningham.

Q Were they officials of the stock exchange?

A Yes.

Q And they in turn reported to the Board of Governors, is that correct?

A Yes.

Q "HES," reads the typewritten note on November 7, 1968, "Re: McDonnell & Co., Incorporated.

"I am told that McDonnell & Co. has lost several VP's."

Is that vice presidents, sir?

A That is vice presidents, yes.

Q "(7-8) after the death of Sean McDonnell. In addition, Mr. McKay is in poor health and the man they hired to relieve him has left the firm. Their operations' and control is therefore said to be declining rapidly. Please give me a report on how latest information we have looks in comparison with period in which we restricted them."

Was that a reference to April, 1968?

A I assume it was, yes.

Q And then this is your reply -- this is your handwriting, isn't it, at the bottom?

A Yes.

Q "RMB: The attached summaries will show the progress and lack of it since April for McDonnell. As the firm is currently being audited the results should help to find the firm's condition when they are available. Meanwhile, the October M--6 and operations Q due in a few days will further clarify the picture."

What was the occasion, or was there a particular occasion, for Mr. Bishop to send you that note?

A I have no knowledge.

MR. BROOKS: I object to the question, your Honor. Other than what's explained in the note--

MR. BEEBE: That is my question, is there anything beyond that.

THE COURT: He has answered the question, go ahead.

Q The attachments, sir, also marked in evidence, was that an updating-- well, what was the attachment? Can you describe it?

A It is a summary of the conversion of their computer system and a summary of their operations questionnaires, in a sense.

Q Is it accurate that the firm planned to make its computer conversion and have it completed first in early May?

A I don't recall.

Q Was that what your records at that time indicated?

A That is what the records day, yes.

Q And then that it was to be completed the 1st of June or the 1st of July?

MR. BROOKS: Your Honor, all that we are doing is asking the witness --

THE COURT: I was going to say, you are doing nothing more than reading his records; is that right?

MR. BEEBE: I am trying to ascertain if this is the situation at the time.

THE COURT: Why don't you ask him if the memo refreshes his recollection as of the time.

Q Was this a complete summary of the situation?

A As recorded to us by McDonnell & Company, yes.

Q And you checked on it, too, didn't you?

A I had no way of checking.

Q Well, did the coordinators have the duty to verify that information they were furnished was accurate?

A I relied upon, as did the other coordinators, on the different specialists to report to me what they found at the times that they were supposed to be finding and looking for things.

Q After receiving this memorandum from the head of the Department of Member Firms and your response, were any steps taken by the Department of Member Firms or anyone else concerning McDonnell & Company's condition?

MR. BROOKS: I object to the question unless there is an end to the time period on which the inquiry is made.

Q I would be perfectly happy to bracket by saying the end of 1968.

A There was nothing done. Is that the answer to your question?

Q Yes. Did you continue to be the coordinator in charge of McDonnell & Co. throughout the end of 1968 and into 1969?

A That's correct.

Q Did you observe the condition at McDonnell & Co. after this memorandum of November 7, 1968?

A From the reports, yes.

Q And what did the reports indicate to you was the condition of McDonnell & Co. after that time and up to the end of 1968?

A They were having operational problems.

Q Was it a continuation of the same problems reflected in this memo?

A Substantially, yes.

Q Did it improve or worsen, remain the same?

A Without examining the record I find it very difficult to answer that.

Q I am asking your recollection, sir.

A From direct recollection I don't recall.

Q Was McDonnell & Company, according to the records you have available, as of November, 1968, in violation of the stock exchange rules?

A To the best of my knowledge, no.

Q In your note in response to Mr. Bishop's question you said that the firm is currently being audited. Were you awaiting the results of that audit?

A That's correct.

Q What were you going to do when you received the results of the audit?

A Do whatever the various specialists that review the audit suggest should be done.

Q Was it the specialist's function to suggest what should be done based on audit results?

A In many cases, yes.

Q Who were the specialists on this account?

A The examiners, Mr. Spies, Mr. Newman, Mr. Jolenz, and many others.

Q Was Mr. McElroy one of the examiners?

A He was.

Q I believe the audit started on October 31, 1968. How many days does the firm have or the outside accountant

firm to complete the audit under the exchange rules?

THE COURT:: I think we have established that with other witnesses quite clearly.

Q Did it come in on time?

A No, it did not.

Q What was th[illegible]son for the delay?

A I don't recall the specific reason the auditors gave.

Q Was there one delay or more than one?

A I believe there were two.

Q Two you say?

A I don't recall.

Q After the first delay or the second delay, did there come a point when you became concerned with the delays?

A Yes.

Q What was the reason for your concern?

A Because customarily there was one delay and it was permitted and then you try to find out why there was possibly another delay.

Q What did you find out when this happened with McDonnell & Company?

A The auditors were having problems getting their audit summarized, I believe.

Q Did they indicate to you that they noticed or were going to report a net capital violation?

A The auditors didn't report that to me.

Q Did you hear any other word from the auditors either directly or indirectly at the time they were asking for their delays as to what they were going to report?

A Could you rephrase that question, please?

Q The auditors asked for delays, didn't they?

A That's correct.

Q After they asked for the first delay and the second delay, did you ask them or did someone at the exchange under your direction ask them what was the reason for the delays?

A I don't know.

Q When we are talking about delays, we are talking about the period November and December, 1968; is that right?

A I believe the report was due on December 15th.

Q Who is Mr. McKay?

A He was the vice president, I believe, of operations at McDonnell & Company.

Q I show you another document which I guess was not pre-marked. It might have been and we might have lost the slip, which is a memo dated November 4, 1968.

(Plaintiffs' Exhibit 36 marked for identification.)

Q And I ask you if that is your signature on the bottom -- your initials are on the bottom and the re, r-e line is McDonnell & Company?

A That's correct.

Q Is this memorandum of a coordinator's discussion with yourself and others in the Member Firm Department?

A That's apparently what it says.

MR. BEEBE: I offer this as the next plaintiffs' exhibit.

MR. BROOKS: May we see copies of that?

MR. BEEBE: Yes (handing).

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 36 received in evidence.)

Q Were you also concerned as the coordinator at that time with the continuing inability of the firm to conduct a box count, the fact this had dragged on so long?

A A firm is only required to have a box count once a year. If the firm has been having operational problems, and there were many of them, the coordinator was certainly interested in a box count as soon as possible.

Q Apparently this was a memorandum of a meeting you people had had; is that right?

A I beg your pardon?

Q This was a memorandum recording a meeting that

you had in the coordinator's group?

A Yes.

Q "Because the firm had been unable to do securities and box counts as they intended because of the conversion to IBM360/40 since October, 1967, it was determined that the firm be asked whether its stock record was in balance."

Did you ask them?

A If you go to the second paragraph you will find that Mr. Schroeder said that the box was currently under the control of the auditor.

Q So you didn't ask them at that point?

A Didn't have to.

Q There is a reference in there, in that same sentence that you have just referred to, to the firm's letter of October 14, 1968, being reviewed, and that is, I believe, the document we marked for identification earlier but not in evidence yet. Is that Exhibit 30 for identification which is dated October 14, 1968, from the firm?

A That's correct.

MR. BEEBE: I now offer that in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 30 received in evidence.)

Q Now, sir, in January, 1969, after the auditor has requested these delays, did there come a point when you

learned from Mr. McKay that the auditors were going to report the firm in net capital violation?

A Yes, I did.

Q When did you learn that?

A I don't recall the date.

Q What do you recall about the conversation in which Mr. McKay informed you of this fact?

A I don't recall too much of the conversation specifically. I do recall that Mr. McKay said that the auditors were going to report a capital violation.

Q And what did you do in response to this information?

A I notified my superiors.

Q Who did you notify?

A I don't specifically recall.

Q Well, in the normal course of things who would you notify?

A Mr. Bishop.

Q Anyone else? Would you notify Mr. Stock?

A I don't recall whether Mr. Stock was acting as, if you will, the chief coordinator of my group of firms at that time.

Q Did Mr. McKay report to you any plans to raise new capital?

A I don't specifically recall.

Q Well, do you recall generally?

A Are you talking about this specific conversation?

Q Yes, the first time that you learned from Mr. McKay that there was going to be reported a violation by the auditors?

A I don't recall.

Q Do you recall what Mr. Bishop said when you told him this information?

A I believe I sent it down in a memo.

Q To Mr. Bishop?

A Yes.

Q Do you have a copy of the memo that you sent to Mr. Bishop?

MR. BROOKS: Is the question does the witness have a copy of the memo?

THE COURT: That's the question.

MR. BEEBE: Witness' counsel.

MR. BROOKS: Well, counsel is looking for it. You have to give us a moment.

(Pause)

MRS. LICHSTEIN Is this the document you are referring to, Mr. Beebe?

MR. BEEBE: Yes, thank you, Miss Lichstein.

Q I show you a copy of a memorandum dated January 13, 1969, the re line is McDonnell & Company and ask you if those are your initials on the bottom.

A Yes.

Q Is that the memo you are referring to?

A That's the one.

MR. BEEBE: I offer that as the next plaintiffs' exhibit.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 37 is received in evidence.)

Q Does that remind you that Mr. McKay reported to you that the firm needed a million seven hundred thousand dollars in order to come down to the 2,000 per cent limit?

A That's what it says, yes.

Q McDonnell & Company planned to raise $1,700,000 to make up the deficiency?

A That's what he told me, yes.

Q Did you know before Mr. McKay telephoned that there was an apparent net capital violation at McDonnell & Company?

A I don't recall.

Q Sir, before January 13, 1969, was there any time that you had heard any inkling that there was going to be a report of a net capital violation at McDonnell & Company?

A Before January 13th? Yes.

Q What was that?

A I believe Mr. Carley in the examiner's department indicated to me that the auditors would probably or possibly report a potential capital violation.

Q Is Mr. Carley the man who prepared the white sheet?

A That's correct.

Q The one previously marked here Exhibit AA.

Was Mr. Carley at the scene at McDonnell & Company during the course of the audit?

A To the best of my knowledge, no.

Q Where did Mr. Carley learn that they were going to report a violation?

A Anything I say would be an assumption.

Q When did Mr. Carley tell you this?

A I don't recall.

Q Sometime before you got the call from Mr. McKay?

A Yes.

Q A week, two weeks?

A I don't recall.

Q Can you try and pinpoint it somewhat for us, sir?

A Impossible.

Q What did Mr. Carley tell you?

A As I suggested before, that the auditors were possibly going to report a potential capital violation.

Q Was Mr. Carley in touch with the auditors? Was that part of his job?

A I don't know what Mr. Carley's specific job was.

Q What would be the occasion of Mr. Carley talking to the auditors?

A Anything I tell you is surmise on my part.

Q Well, sir, was Mr. Carley part of the department that you were working in?

A No. He was part of the examiner's department.

Q What was his occasion for calling you to

tell you this?

MR. BROOKS: I object to the question.

THE COURT: It has been answered already.

Q The occasion was to bring you up to date to this development.

A That is correct.

Q Did you write any memo about that conversation?

A I don't recall.

Q What did you do with the information when you got it?

A I don't recall.

Q May I follow that exhibit with you for a minute? It says:

"McKay has been informed that upon analysis of their questionnaire he, a representative of their auditors, and whoever else he feels is necessary will be requested to come to the exchange and discuss with us our analysis of the questionnaire."

Who informed McKay of that?

A I probably did.

Q Did Mr. McKay tell you in that conversation how he planned to raise $1.7 million or how the firm planned to raise it?

A I put down what Mr. McKay told me in my memo.

Q There is nothing in here about that subject, as I see it.

A Then he didn't tell me.

Q Did he make any argument with you that McDonnell & Company should be exempt from the 2000 per cent limit?

A No, he did not.

Q Did he askyou to suspend the rules as to McDonnell & Company?

A He did not.

Q Did he tell you in words or in substance that the people who were going to contribute the $1.2 million he talked about, according to this memo, would be informed about the fact that the auditors were going to report a violation?

MR. BROOKS: I object to the characterization. It doesn't say anything about people contributing $1.2 million. It just talks about raising $1.2 million in capital.

MR. BEEBE: I think that's a pretty --

THE COURT: No, sustained.

Q Did he tell you anything about the people

or institutions or whatever source he had for the $1.2 million that was going to be raised, these people or institutions or whatever you have, being told by himor anyone at McDonnell & Company what the situation was at the company?

MR. BROOKS: I object to the question.

THE COURT: No, overruled.

Did he say anything in this area to you?

THE WITNESS: No,he did not.

Q Did you say anything to him?

A That was not my concern.

Q I take it you did not say anything to him?

A No.

Q Whose concern was it?

A Division of finance was the department or the organization or the group of people that were responsible for the capital area.

Q Could you make another try though? I asked you whose concern it was.

THE COURT: I'm not sure you and the witness are using the word "concern" in its identical meaning.

Q I was trying to pick up from your last question, sir, when you said it was not your concern. I take it you meant it was not your responsibility?

A Yes.

Q My question is whose responsibility was it?

A I and I said the financial division.

Q Not the member firm division but the financial division?

A The financial division was a part of member firms.

Q Now I'm somewhat lost. You were not part of the finance division; is that right?

A I was not.

Q Do you know ifanyone at the division of finance informed these potential investors of the condition of McDonnell & Company?

MR. BROOKS: I object. We have not found any potential investors.

THE COURT: Sustained.

Q "The firm is currently raising one point two million in capital and is looking for other funds, especially in view of the two partners who are leaving and taking some $400,000 with them."

Now, my question is directed to the firm currently raising $1.2 million in capital.

A Now, what is the question?

Q My question is as to those $1.2 million of

anyone at the exchange informing the people or whoever it was that --

MR. BROOKS: I object to the question. We have heard testimony to the effect that you can raise capital internally simply by selling securities and removing a haircut. There is no assumption ot be drawn from this language that there is any people involved.

MR. BEEBE: I would beg to differ.

". . .and is looking for other funds."

THE COURT: You are dealing with this witness and his state of knowledge and his responsibilities. Go ahead on that basis.

Q Just trying to exhaust your knowledge, sir, do you know of efforts made by the division of finance to inform the people from whom the 1.2 million was being raised?

I will withdraw the question and start that again.

Q Do you know if he was going to raise funds or he was talking about raising funds outside of the firm?

A Mr. McKay said the firm was trying to raise money. That is as far as my interest went.

Q Who were the two partners who were leaving

and taking some $400,000 with them?

A I have no idea.

Q Did Mr. McKay explain to you how he intended to raise the balance of the funds that are indicated is necessary here? According to this memo it says 1.7 is necessary to bring the ratio up to 2000 per cent, and he is raising 1.2 million. I take it the difference is a half million dollars. Did he explain where the balance was coming from?

A I believe that was Mr. McKay's business.

Q He didn't explain to you?

A No.

Q And you didn't ask?

A No, I didn't.

Q You talked about having heard from Mr. Carley before this, you don't know when, about this impending finding by the auditors. Was this the first time, this January 13th conversation, that you heard directly from Mr. McKay about it?

A I would say yes.

Q Let me showyou a memo dated January 9, 1969. The opening line is "Talked today with Tom McKay."

I ask you if that refreshes your recollection.

A Yes.

Q You say yes, it does refresh your recollection?

A Yes.

Q That's a memorandum of an earlier conversation you had with Mr. McKay on the same subject, isn't it, sir?

A Yes.

Q Those are your initials on the bottom, is that right?

A That's correct.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: Is the attachment offered with it?

MR. BEEBE: That's how we got it, Mr. Brooks. I notice the numbers are sequential in the document production. If it came out of the stock exchange files that way, which is apparently the way we received it, I would offer it with the attachment. Why don't we have voir dire and ask him if the two are related.

Q Sir, is the attachment something that you attached or someone at the exchange attached to the memo at one point?

A It has no relationship.

Q They are completely unrelated.

A I beg your pardon. They are related but they are not related to the document per se.

MR. BEEBE: I'm willing to pull them apart. I offer the first page.

THE COURT: Received.

(Plaintiffs' Exhibit 38 was received in evidence)

Q Does this remind you that you had a prior conversation with Mr. McKay on the audit that was about to be finished?

A It does.

Q On the subject of the second extension?

A Right.

Q Andyou informed McKay, didn't you, that no further extension would be granted for typing and therefore the firm would be delinquent in filing the report?

A That is correct.

Q And you discussed the content of the report with McKay. Did you have a copy of the report at that point?

A No.

Q Did you have a draft?

A No, I did not.

Q Did McKay?

A No -- I don't know.

Q How did you discuss the content of the report with McKay?

A He was telling me.

Q How did he know the content, do you know?

A I don't know.

Q It says, "And it appears that the firm wi[illegible] be in violation of the capital rule after all short differences are charged to capital."

Did you discuss that with McKay, too?

A This is apparently what Mr. McKay told me.

Q Then it goes on in the last paragraph to say "McKay indicated that the recently filed documents for an additional $1 million in capital and are further negotiating with an institution for more subordinated funds."

I have read that exactly, although I don't think it's grammatical.

Did he tell you what documents were being filed for an additional $1 million in capital?

A Specifically, no.

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Q Generally.

A The subordinated lenders or anybody who was putting capital into a firm had to file documents with the secretary's office.

Q Would it just refer to subordinated lenders, would you know, sir?

A I believe it would, yes.

Q And it says -- I assume they, the firm, are negotiating with an institution for more subordinated funds. What institution was that?

A I have no idea.

Q Now, at that point did you discuss with Mr. McKay at all what the subordinated lenders who were the subject of this discussion were being told.

A I did not.

Q Would you explain why you didn't?

MR. BROOKS: I object to that.

A That was my business.

THE COURT: Overruled. Go ahead.

Q Did Mr. McKay inform you that he was bringing those subordinated lenders which were the subject of this conversation in this memo up to date on recent developments?

A I don't recall.

Q Didn't you put everything in this memo that he told you in the conversation? Were there some things you left out?

A Conversations may well have contained social pleasantries, and so forth.

Q Putting social pleasantries aside for the moment, though, sir, there is nothing in there that I can see about what he was going to tell the lenders. Is there anything in there?

A There is not.

MR. BROOKS: There is nothing in here about subordinated lenders, either. I object to the question.

MR. BEEBE: I read subordinated funds.

MR. BROOKS: I don't read lenders.

MR. BEEBE: I think that is a line we are

getting pretty fine on.

THE COURT: The exhibit speaks for itself.

Q The question, sir, is: You said you don't recall. Do you know as you sit there of anything he told you about what this institution, or the individuals from whom the subordinated funds were coming, what they were told about McDonnell & Company, if anything?

A I don't recall him telling me anything.

Q You told us what you did with the January 13 memo, which is the first time you recalled that he telephoned you. I notice on the copies on that memo there is no indication for Mr. Bishop. I thought you said it went to Mr. Bishop, or at least was circulated to him. Would that refresh your recollection that it was sent to the people shown on the copies, who I believe were Mr. Schroeder, Newman, Spies and Nalewaik?

A Yes.

Q Those are thepeople who got it?

A Those on the list obviously got it, yes.

Q Did the higherups also get it?

A I don't recall.

Q What did you do after the January 9 conversation, which was four days earlier? What did you do with the information that he gave you, that the firm would

be in violation of the capital rule after short differences are charged, according to the auditor? What did you do with the information?

A Anything I tellyou would be a supposition. It could have been any of a dozen different things I did with that information.

Q I am not asking about any supposition. Tell us precisely what it was that you, the New York STock Exchange did as best as you can recall?

A In this specific instance?

MR. BROOKS: I think he has exhausted his recollection.

MR. BEEBE: I would like an opportunity to probe, but apparently I have gone as far as I can.

Q Did there come a time when you had meetings at the New York Stock Exchange, as indicated in the January 13 memo -- you remember, where it said after the report comes in they will be called in for discussions.

A Yes.

Q Those discussions took place, I take it?

A Yes.

Q Would you deucribe for us what happened at those meetings, the first one that you can remember?

A The first meeting I believe was held around

the end of January, at which the firm was represented, the auditors were there, and members of the staff of the stock exchange were there.

Q Who called the meeting?

A I believe I called the meeting.

Q Was there any discussion of raising capital at that meeting?

A Yes, sir.

Q Would you relate for us what the discussion was?

A Specifically, Mr. Bishop came into the room, and indicated to the officers of McDonnell & Company that they had to raise a specified amount of capital by such and such a date.

Q Then did he leave?

A Then he left.

Q Was there any preliminary discussion by Mr. Bishop before he did this?

A I don't recall.

Q Did he in that speech that you have just related say anything about how the capital was to be raised?

A I don't recall.

Q Did he say one word that you can recall

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about informing the capital investors about McDonnell & Company's condition?

A I don't recall.

MR. BROOKS: I object. There has been no indication of capital investors so far in the record.

MR. BEEBE: There was a discussion of subordinated funds in here.

Q Is one of the way --

THE COURT: The answer is that he didn't say anything on that subject at all specifically, generally or any other way. Isn't that it?

Q That's how I hear it. Did the Judge just summarize it correctly?

THE COURT: Mr. Schuette, in connection with the statement about raising funds, was anything said about informing anyone?

THE WITNESS: No, I said. I said no.

Q Was the firm, according to the auditor's report, in a weak or a poor capital position as of October 31, 1968?

MR. BROOKS: I object, your Honor.

THE COURT: Sustained.

Q Could you explain what your conclusion was, reviewing the auditor's report, as to the firm's

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capital position?

MR. BROOKS: I object, your Honor. There has been no foundation to show Mr. Schuette ever saw the auditor's report as such.

Q I show you a copy of what's previously been marked Exhibit Z, I believe. I ask you if you saw that at that time in the course of your duties as coordinator, and ask you if that is the report Mr. McKay was talking about (handing to witness).

A I don't know.

Q Sir, are you familiar with auditors' reports?

A Yes, I am.

QAnd was McDonnell & Company one of the companies under your duties to supervise as a coordinator?

A That's correct.

Q That was introduced by the stock exchange as the audit of McDonnell & Company. Do you have any doubt that that was the audit?

A I have no doubts if you say so.

Q And was it your practice and procedure at that time to receive the audit when it came in?

A It was not.

Q Did you receive the audits of any firms when they came in?

A Never.

Q Were the audits forwarded to you when a firm had a serious problem?

A They were not.

Q What was forwarded to you in the way of information about the results of the audit, if any?

A A summary of the white sheet.

Q I have here what's been marked by the exchange as Exhibit AA. I believe Mr. McElroy testified that was the white sheet.(handing to witness)

Is that Mr. Curley's summary of the white sheet?

A It appears so, yes, sir.

Q Did you receive that on or about the date indicated, January 27th?

A I don't receive the white sheets.

Q Explain what you do receive.

THE COURT: He said he received a summary.

A I received a summary of the white sheet.

Q I don't happen to have the summary handy,but the white sheet I believe had on the ratio as of October 31, 1968, one net capital ratio figure of 3,992 per cent, and another one of the 2,771 per cent: was that the same information given to you in the summary?

A Yes.

Q Does that indicate a serious financial problem at McDonnell & Company?

A It indicates a potential financial problem, yes.

Q What is the danger if a firm continues in the financial condition indicated by that for---

MR. BROOKS: Your Honor, I object to the use of the term "financial condition." This white sheet in all the discussion thus far has indicated that the problem was a net capital problem. I suggest that that is much different than a financial problem and we ought to use the proper term.

MR. BEEBE: I believe the witness testified that--that is exactly the bridge I was trying to make by the examination, I say that there was indeed a financial problem and not just some technical problem, and that the witness made that bridge in his testimony.

I would like to pursue this line of questioning.

THE COURT: Let's find out whether he did or not. Why don't you explore it.

Q Sir, based on your understanding of McDonnell's condition, having reviewed information about the company since May of 1968, having recommended that it be placed on restrictions, having received a summary of the audit, were you in a position to consider its financial condition?

A Financial condition, no, sir.

THE COURT: We will take our recess now, ladies and gentlemen.)

(Recess.)

BY MR. BEEBE:

Q Mr. Schuette, before the break this afternoon I was asking about your attendance at various meetings in January, and I show you a memorandum dated January 28, 1969, and ask you if that is a review that you made of McDonnell's financial questionnaire in preparation for those meetings, or for a meeting?

A It was not my responsibility to review the financial questionnaires.

Q You say it was not your responsibility?

A To review the financial questionnaire, it was not.

Q Okay. That is your signature on it, isn't it?

A That's correct.

Q Your initials?

A That's correct.

Q Is that your handwriting that says "net worth, 16 million" and so on?

A It appears to be it, yes.

Q And the word "charged" next to the short differences, is that your handwriting?

A Yes, sir.

MR. BEEBE: I offer that as the plaintiffs' next exhibit.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 39 received in evidence.)

Q You say it was not your responsibility to make a review. This is signed by yourself, and it starts "A preliminary review of the examiner's analysis of McDonnell's financial questionnaire showed the following" and there is a list of items. Was that part of your responsibility, to review the examiner's analysis?

A The finance division reviewed the examiner's analysis.

Q Could you explain what the occasion was then for your preparing this memo?

A Specifically?

Q Or generally, if you can't specifically.

A I may well have talked to Mr. Curley about this, or to Mr. Spies about this, to get their impression of their analysis, or of the analysis, of the financial questionnaire.

Q You did prepare this memo, didn't you?

A Yes, I was supposed to be informed of what was going on at the firm.

Q In other words, they informed you and you prepared this memo?

A Yes.

Q And then what did you do with the memo?

A I probably put it in my file.

Q What was the purpose of preparing the memo?

A To add to the information that we had on the firm.

Q Was it circulated to anyone else in the member firms department?

A I don't recall.

Q The last paragraph reads "It was determined that when the examiners complete their analysis and white sheet of the report a meeting with Thomas McKay and other pertinent partners would be held with GHN to make certain additional capital was being obtained to put the firm on sound footing."

Who made that determination?

A I would guess Mr. Newman.

Q And was the firm on sound footing at the time January 28, 1969?

A On the basis of the financial questionnaire it was indicated that there was a net capital violation.

Q My question is was it on sound footing?

A I thought I answered that. It was apparently a net capital violation.

Q I hear you saying that. Does that relate to sound footing?

A I don't think I was to be a judge of that.

Q In your memo here you said, "To make certain additional capital was being obtained to put the firm on sound footing." Is it fair to say --

A I assume this meant that their capital, potential capital violation was either eliminated, if it existed, or their capital ratio was brought up to the exchange's requirements.

Q They were not on sound footing at that point, were they?

A I was not in a position to determine their financial sound footing.

Q I am only asking because it is in the memo.

THE COURT: Mr. Beebe, this is argumentative. He said what his answer is. You can argue the characterization

of it at a later time.

Q Moving ahead, Mr. Schuette, did you then have this meeting with the McDonnell & Company people, and I show you a memo which we have marked for identification as one of the plaintiffs' exhibits dated January 29, 1969. Your name is one of those present at the meeting. Is this a memorandum of that meeting?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: May we see copies, Mr. Beebe?

(Pause)

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 40 received in evidence.)

Q Have you had a chance to look at this memorandum before today?

A Yes.

Q Recently?

A Yes.

Q How recently?

A Within the last week.

Q Does this memorandum record everything that went on at that meeting as best you can recall it?

A I don't know.

Q Do you know of anything that is not in the

memorandum that went on in the meeting?

A I don't specifically recall.

Q Do you recall anything generally that went on at the meeting that is not recorded in here?

A Yes.

Q Could you tell us what it is?

A There was some discussion between the auditors, the firm and Mr. Newman and Mr. Beliakow about what constituted good capital in certain areas.

Q What areas was that?

A Specifically, the discussion was about receivables.

Q Apart from that discussion with the auditors about receivables, was there anything else that's not in this memo that went on in that January 29, 1969, meeting?

A I don't recall.

Q Going back to Exhibit 39, your memorandum of the day before, January 28th, do you have that in front of you, sir?

A Yes.

Q You mentioned it was your handwriting that wrote "charged." Did that mean that the short differences were beingcharged to capital?

A The word "charged" meant that somebody told me that the short record differences were charged, and I made

a notation of it.

Q A hundred per cent?

A I have no idea.

Q Who told you?

A Whoever I discussed this with, whoever examined the white sheet or the finance section, either Mr. Carley or Mr. Spies.

Q Do you know if there came a time when that determination was reversed or altered?

A I don't recall.

Q And looking still at Exhibit 39, sir, what is the capital ratio if the differences are charged? Is it 3,992 per cent?

A 3,992, yes.

Q Did you renew your discussions of imposing restrictions on McDonnell & Co. in January?

A I don't recall the specific time.

Q Now, was there a determination that there had been a net capital violation in January, 1969?

A I think that determination is made by the Board of Governors.

Q Is that determination, based on what you have seen at McDonnell & Company, in 1969 a matter of semantics at that point?

MR. BROOKS: I object to the question.

THE COURT: Yes, sustained.

Q What processes go on between the time that you received the information as a coordinator about McDonnell & Co. and the time that there is some other determination as towhether or not there is a net capital violation?

A The Division of Finance sends out a letter to the firm indicating that there is an apparent capital violation and they request the firm to answer or explain why this appears to be so.

Q And what happens after that?

A Usually a lot of discussion between auditors, examinors, Finance Division on what constitures good capital.

Q And then does it go to the Board of Governors?

A I assume once a determination is made the department of member firms submits a recommendation to the Board of Governors, yes.

Q I thought you said that the Board of Governors makes the determination?

A I don't think -- I didn't say that.

Q Who makes the determination?

A I beg your pardon, the Board of Governors makes the determination; the staff recommends or suggests to the

Board of Governors that a violation exists.

Q Was McDonnell & Co. losing money in the closing months of 1968, sir?

A I don't know.

Q On the bottom of Exhibit 39 there is your handwritten note, "Net worth 16.6 million." You said the purpose of this memo was to bring the files up to date. What was the purpose of writing that letter?

A I assume whoever gave me the information on the analysis of the examiner's analyis gave me that information also.

Q Does that relate in any way to the sound footing that the firm was on or wasn't on?

A I think we are getting into a matter of semantics now.

Q Maybe we are. I am just asking. Is there any relationship?

MR. BROOKS: I object to the question, your Honor.

THE COURT: Put it again from the beginning, please.

Q Certainly. Is there any relation between the firm's net worth and whether or not it is on sound financial footing?

MR. BROOKS: Your Honor, I object. There is no financial near the word sound footing in the memo. I thought

we had determined a while ago that this was just a term that Mr. Schuette had used haphazardly.

MR. BEEBE: I think the words have to be carefully chosen, your Honor.

THE COURT: You are trying to establish what the facts are. I don't think there is a sufficient foundation for the question you put way back, so I will sustain the objection to it.

Q Sir, I will ask it very simply. Why did you write down what the net worth was?

A Because somebody in analyzing this white sheet, and so forth, told me that the net worth was 16.6 million.

Q How is it relevant to what you were doing here?

A Not at all. I don't see any relevance.

Q The aggregate indebtedness at the time was $114,000,000, wasn't it?

A I don't know.

Q On the top of that sheet is indicated "aggregate indebtedness $114,716,000."

A That's what it says.

MR. BROOKS: If we are going to read the document I think it speaks for itself.

THE COURT: He is going to put a question on it. Go ahead.

MR. BEEBE: I can't do things out of context, your Honor.

THE COURT: Go ahead.

Q My question is, and I believe I just asked you what the relationship is between aggregate indebtedness and net worth.

A I don't see any.

Q Are you familiar with a document known as knowledgeability letters?

A Yes.

Q Did the exchange have a practice under certain conditions of requiring firms that were raising funds to provide the exchange with a memorandum note, knowledgeability letter?

MR. BROOKS: I object to the question unless we get a date that goes with it.

MR. BEEBE: Your Honor, I am glad to interject a date but I would like the opportunity to finish my questions.

MR. BROOKS: I'm sorry, Mr. Beebe. I thought you had.

Q Limiting ourselves for a moment, sir, was this practice in effect for some time at the exchange, say, the middle of 1969?

A I couldn't tell you, Mr. Beebe.

Q Well, then, let's talk about what you know about knowledgeability letters.. What were the circumstances when knowledgeability letters were required from the potential lender?

MR. BROOKS: Your Honor, I don't think we have ever determined that they are required.

THE COURT: Yes, sustained.

Q Were there circumstances when the firm -- that was the question that was interrupted. Let me start that question in a general way again.

Were there certain circumstances when the New York Stock Exchange required firms to furnish knowledgeability letters?

A There were.

Q And were those knowledgeability letters required when the firm was going after additional subordinated lenders?

A I don't know.

Q Let me direct your attention to page 46 of your deposition which you gave earlier under oath in this case I believe on May 3, 1973. Do you recall giving that deposition?

A Yes.

Q Earlier it was established that the date involved

was 1969. "Was there a practice and procedure at the exchange to that effect" -- that is requiring knowledgeability letters -- "as of 1969?"

Then reading on 146, this is your answer, "The exchange under circumstances would require a firm going after additional subordinated lenders to provide the exchange with a memorandum or note or letter or something to the effect that they were aware of the financial condition of the firm they were putting money into."

Was that your answer?

A Yes.

Q Was that true?

A To the best of my knowledge, yes.

Q Still true today, isn't it?

A Yes.

Q "Q Your answer referred to the firm under circumstances." You probably meant under certain circumstances. What would be the circumstances when a firm would be required to give knowledgeability letters?

MR. BROOKS: I object, your Honor. The transcript reads "the exchanges under certain circumstances would require."

MR. BEEBE: That's my question. What are the circumstances when the exchange required it.

THE WITNESS: I don't know, Mr. Beebe.

Q You don't know what you were referring to when you gave this answer?

A Yes, I knew what I was referring to.

Q What circumstances were you referring to when you gave that answer?

A General knowledge of the types of circumstances, that's about all.

Q Well, what were the types of circumstances, sir?

A The firm had a case before the SEC, some lawsuit against the firm, capital ratio problems; many of them.

Q Capital ratio problems was one of them, wasn't it?

A Yes.

Q McDonnell & Company had a capital ratio problem as of the end of January, 1969, didn't it, sir?

A It appeared they had a capital ratio problem, yes.

Q Is there any doubt in your mind they did?

A I am not qualified to determine what is good capital or not.

Q Was there any doubt in your mind they appeared to have one?

A There is no doubt in my mind that they appeared to have a capital problem.

Q And that the auditors sent an audit which was

summarized from you which included the ratio in the summary of 3,900 per cent, a second ratio of 2,700 per cent; is that right?

A That's correct.

Q We have talked a lot about knowledgeability letters and asked questions about them. Would you or your counsel have a copy of a sample of one that was in existence at that time?

A No.

MR. BEEBE: That's really directed to Mr. Brooks if he has one we could use in terms of the examination here, as a sample.

MR. BROOKS: Although I would certainly be pleased to represent Mr. Schuette, I don't happen to do so in this proceeding. I think there was a deposition exhibit marked some time ago which we both should have a copy of. If counsel wishes we will try to find it for him.

MR. BEEBE: I will go ahead and maybe come back to that area. I appreciate it.

Q Are you represented by counsel here, sir?

A I suspect not.

Q Did you think you were before?

A No.

Q Have you met with counsel before this testimony

in the last week or so?

A Yes.

Q You have met with Mr. Brooks?

A That's correct.

Q How many times?

A Once.

Q Do you know if knowledgeability letters were required by the exchange in connection with the raising of subordinated funds late in January, 1969?

A Specifically or generally?

Q Either way, sir.

A Generally, yes.

Q They were required in this case?

A Not required, they were requested.

Q Who requested them, sir?

A I don't know specifically who requested them.

Q Generally, who requested them, please?

A I assume Mr. Bishop requested them on the advice of the examiners of the Finance Division.

MR. BROOKS: Your Honor, I have found what Mr. Beebe asked for, a form entitled "Knowledgeability Letter," attached to a letter dated May 21, 1969, addressed to McDonnell & Company which was marked as Plaintiffs' Exhibit 153. I will be glad to make my copy available(handing).

MR. BEEBE: Thank you, sir.

Q Going back to what you just said, though, you are sure that Mr. Bishop requested it. Do you know if they were required?

A I don't believe they were required.

Q Who was the request made to?

A I believe the request was made to the firm.

Q By Mr. Bishop?

A By Mr. Bishop or whoever he delegated the responsibility to request it.

Q What is the basis of your statement that this request was made? Just your recollection of what happened.

A Just my recollection, yes, sir.

Q Do you recall why the request was made by Mr. Bishop? Any discussion on the subject?

A Are you talking specifics or generally?

Q Start with specifics and go to generals then.

A I don't recall the specifics.

Q Moving on to the general area, sir.

A Again, I generally couldn't tell you why, under what circumstances was motivated the request for the knowledgeability letter.

Q In this McDonnell case?

A In this McDonnell case.

Q Two of the plaintiffs here today, Margaret Mary Murphy and Mr. James McDonnell. Do you know if they executed knowledgeability letters?

A I have no idea.

Q But you do know the exchange asked McDonnell & Company to get the knowledgeability letters?

A I am learning something new right now.

Q I thought you just testified to that. You confuse me. Did you know that Mr. Bishop had asked someone at McDonald & Company to get knowledgeability letters?

A I did not know.

Q Did you just testify concerning McDonnell & Company and the request for knowledgeability letters there, five minutes ago?

A Could you repeat what I said?

Q We will have a record of this tonight and we will take a look at it.

After a knowledgeability letter is submitted by the capital contributor to the brokerage house, does it then go to the stock exchange in the normal course of the procedure?

A I assume that's the procedure.

MR. BROOKS: I would move to strike the testimony unless he has knowledge.

THE COURT: Yes, strike it out.

MR. BEEBE: I am asking--

THE COURT: His answer is an assumption and it is stricken.

Q Do you have any knowledge or any experience with knowledgeability - cters yourself in the course of your being--

A No, I have not.

MR. LOFLIN: Your Honor, if I may, I would object to any questions along this line. He has exhausted the knowledge of the witness and we are wasting time. He has a witness available to him who knows more about knowledge-ability letters than this witness does. I don't think this witness is the one to get it in. I feel we are going needlessly into this.

MR. BEEBE: Could you share with me what witness I have available on this subject?

MR. LOFLIN: I will leave that to you to work out and I am confident you will be able to. It is just not this witness.

Q Did there come a time when you learned that Mrs. Anna McDonnell and Mrs. Murphy were making subordinated loans to McDonnell & Company?

A Yes.

Q When did you first learn that, sir?

A I would date it somewhere in February, 1969.

Q Early February?

A I can't specifically say.

Q Did you know before then that they were being approached?

A I don't recall.

Q It wasn't discussed in any meeting you attended?

A I don't recall.

Q This Exhibit 40, I believe it is, a memo of your meeting on January 29th with the company, could you look at that for a moment and see if there is anything in there about who was being approached for funds, if any persons were being approached?

A Three existing subordinated accounts.

Q What are you referring to?

A The last paragraph.

Q And the last paragraph I believe, am I correct, was added?

A It was added after, you are correct.

Q So as of the meeting itself there is no reference to who was being approached; is that correct?

A That's correct.

Q The last paragraph reads, "Subsequently today the firm informed the exchange that they would have

$1,500,000 new capital by Friday, January 31, 1969, to be placed in three already existing subordinated accounts."

Didyou know at that point that the accounts include Mrs. Anna McDonnell and Mrs. Murphy?

A I did not.

Q Excuse me?

A I did not, no.

Q Did you see this memorandum shortly after it was prepared? Were you on the circulation for this, since you attended the meeting?

A Yes.

Q Did you have any information as to whose accounts those were?

A I had no information.

Q And it wasn't discussed at the January 29 meeting?

A To the best of my recollection, no.

Q Did you continue to review the condition at McDonnell & Co. after January 29, 1969?

A Yes, I did.

Q In your job as coordinator?

A Yes.

Q Did you prepare another one of these information memos you referred to on or about February 20, 1969?

A Specifically, I don't recall.

Q Let me show you this and ask you if those are your initials on the bottom?

A That is correct.

Q A memo dated February 20, 1969. And those are your initials and your reference to the OO file up in the lefthand corner; is that correct?

A That is correct.

Q And a copy to Mr. Bishop. And is that Mr. Bishop's capital B on there?

A That is.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 41 was received in evidence)

MR. BEEBE: May I read from this, your Honor?

THE COURT: Yes.

(Plaintiffs' Exhibit 41 in evidence was read to the jury)

Q Mr. Schuette, was it your understanding at that point in January 1969 that McDonnell's back office --

THE COURT: February.

Q February. That McDonnell's cage was a mess?

THE COURT: The exhibit speaks for itself.

Q Apart from what you read in here, is this consistent with your information?

MR. BROOKS: The exhibit, your Honor, doesn't even suggest that that's Mr. Schuette's belief. It suggests that it's somebody else's belief.

MR. BEEBE: That's what I am asking the witness.

A Mr. Goldman told me this is what he understood.

Q Did you check it out?

A I didn't check it out specifically personally.

Q Was it consistent with your understanding at that point?

A More or less, yes.

Q It refers to a cage. I don't know if we defined what the cage is in terms of a brokerage house operation.

A It's usually the area where the certificates are handled, and it's behind bars, if you will, for security reasons, so somebody doesn't come up and walk away with securities.

Q The next paragraph says that you indicated to Mr. Goldman " We were reviewing the firm with a view towards sible limitations in the light of its operating difficulties. He stated he would defer any possible action by the SEC until he knew which way we were going."

Were you considering possible limitations in light of its oeprating difficulties at that point?

A Certainly.

Q What were the operating difficulties that you referred to here?

A The various fail positions, the inability to

compute or to come up with a one-capital position, the fact that they had short differences, the fact that they were having problems with their computer yet.

Q This morning we marked or earlier we marked as 33A a chronology of events in 1968. If you don't have a copy I will give you my copy. Were these the same kind of operating difficulties that were described in the chronology in 1968 that you prepared on October 28, 1968?

A Substantially the same, yes.

Q Had they gotten any better or had they gotten worse?

A I don't recall.

Q During this period, that is late 1968, early 1969, did the exchange give the assistance to member firms who were having capital problems?

A I don't understand the question.

Q I'm thinking in terms ofconditional approval letters. Are you familiar with conditional approval letters?

A Yes.

Q Will you explain to the jury what a conditional approval letter is?

A The board of governors gave Mr. Bishop, the

department of member firms, the right to conditionally accept for approval additional capital for a firm without the usual long waiting periods.

Q Was this called a special authority?

A Yes.

Q And was this special authority in effect as to McDonnell & Company in late January 1969?

A To the best of my knowledge, yes.

Q Was it exercised in the case of the subordinated lenders who came in at that point?

A Yes.

Q That would include James McDonnell and Mrs. Murphy?

A I don't specifically recall.

MR. BROOKS: Your Honor, I object. James McDonnell was not a subordinated lender.

MR. BEEBE: Well, he doesn't recall in any case.

Q What is the need for special authority?

A The names of subordinated lenders had to be submitted to the board of governors for approval. Under the special authority, as I understood it, if the secretary's office saw that there were possibly no objections to the board of governors accepting the person

as a subordinated lender, the department of member firms could therefore conditionally accept their capital contribution conditionally as good capital.

Q I read you from your testimony, sir, page 160:

"Q Could you tell me what you mean by conditional approval letter?

"A During this period McDonnell & Company, as with all those firms that were having capital problems were -- I don't know how to put this -- being given assistance in terms of improving their capital position, and Mr. Bishop had special authority, as I understand it, from the board of governors to conditionally approve allied members bringing new capital into a firm that had capital problems."

A That is substantially what I said.

Q That's true as I just read it? Isn't that accurate?

A Yes.

MR. BROOKS: Your Honor, I object to reading and suggesting it was different from what the witness just testified to. It seems to me to be exactly the same.

MR. BEEBE: It hink it's quite different and I think it speaks for itself.

THE COURT: The jury's recollection of the testimony will govern. They are the ones to make that decision.

Q Sir, you mentioned you keep exchange of information between regulatory agencies in connection with a document that appeared to be in the SEC format.

Did you also keep the American Stock Exchange generally informed of what was transpiring at McDonnell & Company?

A I don't recall.

Q Was it the general practice, though, to keep the American Stock Exchange informed of problems that would be encountered if a firm was a member of both exchanges?

A Generally, yes.

Q I show you a memorandum and ask if this has your initials on it, entitled "McDonnell & Company"? It has previously been marked for identification. Is that your signature, sir?

A That is correct.

Q Was this also sent to the OO file by you?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: I have no objection.

(Plaintiffs' Exhibit 42 was received in evidence)

MR. LOFLIN: May I ask a question on voir dire, please?

THE COURT: You may.

VOIR DIRE EXAMINATION

BY MR. LOFLIN:

Q Do you know who you got this information from?

A I don't recall specifically. I talked to Mr. Shippy. It may well have been -- I forget the gentleman's last name. James something. It may well have been Vernon Lee. I don't know.

Q Is Mr. Shippy from the American Stock Exchange?

A Yes.

Q It may have come from him?

A Yes.

Q On the other hand it might have come from Mr. Lee?

A It may have.

Q Any other names come to mind as a possible source?

A No.

Q In any event, I gather you feel confident this information came to you from some official of the American Stock Exchange?

A Yes.

MR. LOFLIN: I have no objection.

DIRECT EXAMINATION CONTINUED

BY MR. BEEBE:

Q Who is Mr. Lee?

A An officer of the American Stock Exchange.

Q Is his last name Lee or was his last name Arnie?

A Mr. Lee, Vernon Lee.

Q And Mr. Shippy, is he an officer of the American Stock Exchange?

A No, I don't believe he was an officer. I really don't know how to classify it if they are officers or employees.

Q Who is Jim?

A My memory slips. I don't recall.

Q He was an employee of the American Stock Exchange?

A Junior officer of the American Stock Exchange, yes.

Q Did you mention the name Bernie, the last name after Jim or was that Vernon Lee?

A Vernon Lee is what I said.

Q Were you in regular communication with them in the course of your affairs?

A I guess it depends on the definition of regular.

Q Could you explain how frequently you communicated with them?

A Probably several times a month. Different matters.

Q Was McDonnell & Company one of the matters that you communicated about?

A I don't specifically recall.

Q When you were in charge of McDonnell & Company and there was also a member of the American Stock Exchange, would the subject come up?

A It may well have.

Q Did you keep the American Stock Exchange informed in 1968 and 1969 about any adverse developments at McDonnell & Company?

A I don't specifially recall.

Q Did you keep the SEC, particularly Art Goldman of the SEC, informed about what you were learning in

January 1969 about McDonnell & Company?

A No.

Q Why not?

A Because that wasn't my responsibility.

Q Why did Art Goldman talk to you on February 20, 1969, as indicated in this exhibit?

A Because among the various regulatory bodies the American Stock Exchange, NASD, the SEC and the New York Stock Exchange, we had a contact list of persons in the other organizations which we could contact if we felt we would get some information from them or if some information we had was pertinent to them.

Q And you were on Mr. Goldman's list?

A Apparently I was on Mr. Goldman's list.

Q Whose responsibility was it at the exchange, if anyone, to tell the SEC about what you were learning in January 1969 about McDonnell & Company?

A I have no idea.

Q In the last paragraph of Exhibit 42 -- let me read all of Exhibit 42. It's very short.

(Plaintiff's Exhibit 42 in evidence was read)

Q What was the development?

A This information that I received.

Q About the SEC or the Amex, which information? There seems to be a lot of information.

A The information that the Amex is exploring, the McDonnell situation relative to the Washington, D. C. office and that the firm's margin department was a mess. Also understood that the Amex was to confer with the SEC concerning McDonnell's margin operation.

Q Were you interested in bringing to the examiner's attention the fact that the SEC was concerned?

A Absolutely.

Q Why were you bringing that to Mr. McElroy's attention?

A Because Mr. McElroy and a fellow examiner were in McDonnell & Company's offices at the time.

Q Why was it absolutely important to bring it to their attention, the SEC interest?

A Because if there is a margin problem, if there is a problem that's been discovered by somebody else, it's our responsibility to find out if indeed a problem does exist.

Q Did you pick up the phone and call anyone at the SEC concerning what your examiners were finding?

A No, not specifically that I recall.

Q You said that was someone else's responsibility?

A Yes.

Q Can you pinpoint whose responsibility it was?

A I cannot.

Q Was McDonnell's net capital problem solved by the funds that were -- subordinated funds that were put in at the end of January?

MR. BROOKS: I object. We haven't seen there were any subordinated funds so far with this witness. There is no foundation for this question.

MR. BEEBE: We have evidence over this past week exactly about this.

THE COURT: I know but you are talking about this one witness. Objection is sustained.

Q You testified, haven't you, sir, that you learned at one point there were three subordinated lenders at the end of January 1969?

A That's correct.

Q And two of them were Mrs. Murphy and her mother?

MR. BROOKS: I object, your Honor.

THE COURT: Yes. He said he doesn't know that.

Is that right?

THE WITNESS: That's right.

Q You don't know who they were. In any case, did the funds that came in at that point solve the net capital problem?

A It wasn't my responsibility to watch the firm's capital input and output in terms of its capital position at every point in time.

MR. BEEBE: May I have the question read back.

(Question read)

THE COURT: Objection sustained.

Q I show you this document, Plaintiffs' Exhibit 42 for identification, and ask you if those are your initials up there inthe corner?

A They are not.

Q Whose initials are they?

A They are my initials but not my handwriting.

Q I just meant were they your initials.

A They are my initials.

Q What do the initials up at the corner of the document like this when they are your initials mean in your department?

A If my initials are up there and they are in my handwriting, it means that I have read the

document and have told my assistant to post it in the files, post the document into the files.

Q I believe you told us that. I am asking you when somebody has written your initials there is it a routing to you?

A No.

Q What purpose is served by the procedure.

A I don't follow what you are getting at. Why my initials are up here?

Q Yes.

A I have no idea because it's not my handwriting.

Q You were, of course, well aware of the contents of this letter, weren't you?

A Yes.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: I have a technical problem and a more substantial one. I believe it has been described as Exhibit 42. We already have an Exhibit 42.

THE CLERK: It will be 43 for identification.

THE COURT: What is the number on this?

THE CLERK: 43 for identification.

MR. BROOKS: I don't think it's a sufficient foundation to have Mr. Schuette tell us that he was aware of the contents, without any more, to get the letter admitted.

MR. BEEBE: I believe since this was in his department and Mr. Spies, I believe, was another employee in that department, it's all part of the same package.

THE COURT: Let's cut the Gordian knot by recessing for the evening.

Ladies and gentlemen, we stand in recess until 10 in the morning. Continue my admonition not to speak about the case at home or with anybody else.

Goodnight.

Counsel will stay a minute.

(Jury leaves the courtroom)

THE COURT: Now, Mr. Beebe, how many more witnesses have you?

MR. BEEBE: Six.

THE COURT: Six?

MR. BEEBE: Wait.

THE COURT: Let's assume you have six. For example, with a gentleman like we just had here on the stand, can you take every exhibit that you have in

mind to put in with him, show it overnight or prior sometime to Mr. Brooks and say are you going to have any objection to this, mark it, and at the very beginning of this examination put the whole bunch in.

Because frankly, we could have done today in my judgment in about a third of the time.

Why we had five minutes on whether this was his initials in the corner, what difference it made, he never put it there; so what, quite honestly. We are getting an awful lot of that.

MR. BEEBE: May I say coincidentally I handed Mr. Brooks a list of precisely that, before trial started, and asked precisely that question. I believe he has it under advisement.

THE COURT: Now, next question to you. I am not going to try your case. I don't know what you have in mind with these six witnesses, but I have read your very excellent trial memos two times, I have browsed at them on the subway and over the weekend. Haven't you got the vast bulk of your case in already? All I want to suggest is don't over-try it.

MR. BEEBE: I will certainly abide by that for the sake of the jury and everybody else.

THE COURT: Your position here in essence

is that the exchange knew all about this and had a duty to do something and had a responsibility to these subordinated lenders and didn't do it.

Now, you can prove that by ten witnesses or you can prove it by three. It doesn't seem to me that you are going to have to put everybody all the way up the chain and spend a day and a half for each witness and go through each witness separately.

MR. BEEBE: I think I wouldn't be revealing anything untoward by saying that Mr. Schuette and Mr. Newman are sequential witnesses that take the story through from the beginning of 1968 through 1970. Mr. Schuette signs off in about May. We will be done with him, we will pick up Mr. Newman and that will create a floor of what the facts are.

THE COURT: The same thing, overnight, if you have eight more letters or memos you want to put in, let's have them marked by 10 o'clock in the morning. Let Mr. Brooks know this evening by phone call that these are the ones you are going to offer and ask if there are any objections.

If you have anything that you want him to supplement them with in the way of testimony, get it out, but please don't have him just read it and say "Now,

is that the fact?" unless that is crucial to you.

MR. BEEBE: The only time when I would at least pause myself to read it is when having a document in evidence, the jury is not going to read every one of these --

THE COURT: Read it tothem. The thing we waste time on is they say "Yes, this memo reflects what I remember."

MR. BEEBE: Except to foreclose him from coming back later and saying something else.

THE COURT: You have this on deposition, don't you?

MR. BEEBE: Some of it, sir.

THE COURT: If some of ehse ideas fall on fertile ground, please use them.

MR. BEEBE: They are growing apace.

(Adjourned to May 5, 1975 at 10 a.m.)

MARGARET MARY MC DONNELL MURPHY, et al.

vs. 71 Civ 461
71 Civ 1940

MC DONNELL & CO., INC., et al.

May 6, 1975
10:00 a.m.

Trial resumed.

- - -

(In open court; jury present)

H E R B E R T E. S C H U E T T E resumed.

THE CLERK: Mr. Schuette, you remain sworn.

MR. BEEBE: May I proceed, your Honor?

THE COURT: Please do.

DIRECT EXAMINATION CONTINUED

BY MR. BEEBE:

Q Sir, yesterday I was inquiring about your knowledge as of March 1969 concerning McDonnell & Company, and whether the capital that came in at the end of 1969 was sufficient to solve the net capital problem.

Was that capital sufficient to do that?

A It depended upon whose analysis of the capital position. I assume on the part of the firm it was sufficient, but there were probably questions on the part of the exchange whether it was sufficient.

Q Did the exchange take the position, at least by March 18, 1969, that it was not sufficient?

A From appearances, that's the position, yes.

MR. BROOKS: Your Honor, if that answer is other than the knowledge of the witness I would move it be stricken. If it's knowledge, I think it's proper to be received.

THE COURT: Let's strike it out and see where we get on a more firm foundation. The answer is stricken.

Q Mr. Schuette, I ask you to look at the bottom of the letter dated March 18, 1969, which has been marked for identification. That is Exhibit 43A.

Does that refresh your recollection that "While the amount was considered sufficient to meet capital requirements based on the October response to the questionnaire it appears the corporation's position changed to the extent of such amount, and that such amount did not correct the capital deficiency at the time the additional monies were contributed. This would lead us

to believe that McDonnell & Company, Inc., may have been in capital violation from the time such was disclosed on the October response."

Wasn't that the exchange's position at that point?

A This is what the letter says that Mr. Spies wrote from the Finance Commission to Mr. Thomas McKay, yes, sir.

Q Did you agree or disagree with that?

A I was not in a position to determine what was adequate capital.

Q Excuse me?

A I was not in a position to determine what was adequate capital.

Q You are saying this was outside your realm, you can't speak to that?

A I can't speak to what is adequate capital, that's correct.

Q You are fully familiar with the net capital rule, are you not?

A Not fully familiar. I am familiar with the rule.

Q At the time that was your function, to enforce compliance of that, along with other rules?

A That was part of the function, yes.

Q Was the net capital rule one of those you concentrated on a great deal?

A During this period, yes, sir.

Q Were you in a position to say whether the net capital ratio of over 2000 per cent was a violation of the rule or not?

A I was not in a position to determine what constituted net capital. Therefore, I was not in a position to determine that a violation did indeed occur or had occurred.

Q Were you in a positionto determine whether the ratio was over 2000 per cent?

A From what figures were supplied me I could see whether it said 2000 per cent or more, yes.

Q And my question is: From the figures that were supplied you as of March 18, 1968, was the ratio over 2000 per cent and had it continued to be since October 1968?

A From the figures supplied to me from the analysis of the auditor's report, yes. From the special operations questionnaire supplied by the company, no.

Q Which were right?

THE COURT: Mr. Beebe, this is exactly what I was suggesting at the end of yesterday. All you are getting him to do is he can look at a piece of paper and if it says over 2000 it says over 2000, and if it says under 2000 it says under.

MR. BEEBE: I want to clear up for the jury --

THE COURT: I don't think there is anything to clear up.

MR. BEEBE: When the monies came in the question arises whether they did what they were supposed to do or didn't.

THE COURT: Ask him that. Whether the figures on a page add up to a ratio of over or under 2000, that is just working with an exhibit that is in evidence. If you want to ask him what they did following looking at a piece of paper, that is one thing, but for him to look at a piece of paper and say "Yes, I see what the computation says" I submit that doesn't advance your cause or any cause.

Q Let me ask you, sir: After the monies were put in at the end of January 1969, was the firm in compliance with the rules?

A To the best of my recollection, there was an indication that the firm was in compliance. Again,

from whose point of view?

Q I am asking from the exchange's point of view, since you just broke down your answer into SOQ's and the exchange's analysis. Let's focus on the exchange's analysis.

MR. BROOKS: I object to the question unless it indicates the time of the exchange's analysis Mr. Beebe is inquiring into.

MR. BEEBE: March 18, 1969.

A The computation of a capital ratio is a minute by minute affair, and I couldn't tell you with any certainty exactly when they were or weren't in compliance.

Q That is why I directed your attention to those sentences there that were sent out by someone in your department. Yesterday you testified you were fully aware of the contents of that letter.

A That's what Mr. Spies --

THE COURT: There is no question pending.

Q The question is, sir: did it appear to the exchange that the amount contributed did not correct the capital deficiency? It is a simple question.

A That is what Mr. Spies' analysis letter to Mr. McKay says.

Q Did there come a time when there was a set of answers submitted by McDonnell & Company as to the financial questionnaire as of January 30, 1969?

A Yes.

Q I hand you a document which we have previously marked as Exhibit 43A for identification, and ask you if

you have seen that before (handing to witness).

A I don't recall.

Q In the normal course of your job would the answers to financial questionnaires submitted by the company come to your attention?

A They do not.

Q Do you recall whether in this case the McDonnell & Company answers came to your attention?

A I do not recall.

Q Was a summary of these answers made for you or circulated to you?

A Mr. Spies and I discussed the examiner's analysis of all the financial questionnaires of the firms that were under my charge.

Q Did this come from Mr. Spies?

A I assume so.

MR. BROOKS: I move to strike that.

THE COURT: Yes, strike it.

Q In the normal procedure who would be the person in the department that would receive these answers to financial questionnaires submitted by the company?

A The examiner's department.

Q And the examiner's department at one time was Mr. Spies one of the --

A No.

Q Who would be?

A Mr. Curley and his people.

Q Is Mr. Curley still at the exchange?

A I have no idea.

MR. BEEBE: I offer this as the next exhibit. It is a document that was produced by the stock exchange from its files.

THE CLERK: Any objection?

MR. BROOKS: Yes, your Honor, I do object.

THE COURT: The objection is sustained.

Mr. Beebe, this doesn't mean on a proper foundation at a proper time it may not be admitted.

MR. BEEBE: I appreciate that. We may have to call Mr. Curley, or somebody like that.

Q Now, sir, you continued to be the coordinator in charge of the McDonnell account after March 18th, did you not?

A Yes, sir.

Q I show you a document that's been marked 44 for identification, and I have two copies, one that came from the exchange's files, which is not very legible, and we will call that 44, and I have another copy which we obtained from another source, which is simply more legible..

I will call that 44A.

(Plaintiffs' Exhibit 44 A marked for identification.)

Q Were you the author of that document, sir?

A It sounds like my way of writing, yes, sir.

Q And in the upper left-hand corner of 44A are your initials appearing?

A That's correct.

MR. BEEBE: I offer that as the next exhibit.

MR. BROOKS: What number are you offering?

MR. BEEBE: Both of them. 44 and 44A.

MR. BROOKS: No objection. Except for the underlining in 44A. We can determine whether that is Mr. Schuette's or came about at some time after the writing of this memo.

MR. BEEBE: I have no idea. This is how it came to us. I am willing to offer it without the underlining.

MR. BROOKS: Without the underlining there is no objection.

THE COURT: Very well.

(Plaintiffs' Exhibits 44 and 44A received in evidence.)

Q Did you talk with Mr. McKay in or about this period about requesting emergency approval for two

stockholders?

A Yes, sir, I did.

Q Who were the two stockholders?

A It says Mrs. McDonnell, who apparently was the trustee or co-trustee of some trust, arnd I believe it was another McDonnell family member.

Q Was that Mr. Murray McDonnell's wife?

A I'm sorry, I don't know the relationships.

Q Do you know who the other person was, apart from Mrs. McDonnell, the second stockholder?

A No, I do not.

Q May I read the second paragraph "Outside money in the form of subordinated debentures sold to the First National City Bank and some church organization is being explored. McKay was informed that the exchange wants the firm to have its capital in shape very soon. The strong possibility of restrictions was mentioned with the indication to McKay that this information be passed on to T. Murray McDonnell."

When it says McKay was informed, that was you were informing McKay?

A Yes, sir.

Q And in the third paragraph there is a sentence "When pressed to get capital' McKay mentioned some two

million dollars locked in under an agreement for two years."

Did you press McKay to "get capital"?

A This was the exchange's position.

Q And then the last paragraph on this page "McKay reported that he has discussed the dire consequences of being on restriction with McDonnell, and that such limitations would certainly harm the firm for many months to come. McKay reported that rumors on the street have it that a number of firms are and have been operating for months in capital violation."

Was McDonnell & Company at that time one of those firms?

A As I indicated earlier--

MR. BROOKS: I object. He is reporting something that Mr. McKay has told. It is not anything that the witness is certifying to as his own knowledge. Mr. Beebe's question assumes it is a fact, and I don't think it is.

THE COURT: No. Overruled.

If you know.

A The question, please.

MR. BEEBE: Please repeat the question, Mr. Reporter.

(Question read.)

THE COURT: The form of your question, which is the last sentence is bad. Would you put it again.

Q Do you know, sir, if McDonnell & Company had been operating for months in capital violation?

A From the appearance of the various capital computations I have seen, you could make that assumption.

MR. BROOKS: I object again and move to strike. The witness is just interpreting documents.

THE COURT: Yes. I will leave it stand since it is obvious that is all he is doing.

Q Sir, I take it the answer was not stricken?

THE COURT: It was not.

Q Sir, you mentioned in this conversation with McKay the strong possibility of restrictions. Apparently early in the conversation. Then towards the end McKay argued that this would produce dire consequences.

After that exchange did the stock exchange impose restrictions in March or April on the firm?

A I don't believe restrictions were imposed in March or early April.

Q Or late in April either, were they? If you don't know, why don't we wait--

A I don't know.

Q In your observations at that time and the results of what was reported to you, did you see continuing operating problems at McDonnell & Company during that period of January, February and March, 1969?

A Yes.

Q Did it appear obvious to you -- was it your conclusion that sanctions had to be imposed to cut the problems?

A Can I have a definition of "sanctions"?

Q Did the stock exchange have the ability to impose sanctions in its function as regulating the brokerage houses?

A Yes.

Q That's my definition of sanctions.

MR. BROOKS: Your Honor, that's not a definition of anything.

THE COURT: I didn't see that it was.

Q I meant whatever sanctions the stock exchange had the ability to impose, was it your view that they should be imposed at that time to cut the problems?

A I felt strongly that the company should be subject to further restrictions, yes.

Q Did you express that view to anyone?

A Yes.

Q Who did you express it to?

A To Mr. Bishop or Mr. Stock, I believe at that time was in charge of our section of the coordinators.

Q Mr. Stock is since deceased, I believe?

A Yes.

Q When you expressed these strong feelings did Mr. Stock agree and were sanctions imposed? And I am talking about January, February, March, 1969.

A I don't specifically recall.

Q The fourth paragraph of that Exhibit 44 states, "McKay reported that the firm is about one-half converted to its new system and was running about ten months behind

schedule."

Was that a reference to the computer conversion?

A That's correct.

MR. BEEBE: I offer as the next document a document previously marked Exhibit 45 for identification. I believe there is no objection.

MRS. LICHSTEIN: That's correct.

(Plaintiffs' Exhibit 45 received in evidence.)

MR. BEEBE: I will just read this.

Q Are these your initials down there?

A Yes.

Q It is dated March 27th, which is the same day as the memo we have just been going over about your conversation with Mr. McKay.

(Plaintiffs' Exhibit 45 read to the jury.)

Q What was your occasion for writing that?

A Apparently Mr. McKay had sent me some additional papers for subordinated lenders or stock purchasers of McDonnell & Company stock. Although they should have gone to the secretary, he sent a lot of this stuff to me. So I sent it down to Mr. Jim Baker in the secretary's office to follow the procedure that permitted the Department of Member Firms to give emergency capital approval to new stockholders.

Q That emergency capital approval procedure was in force as to McDonnell & Company at that time; wasn't it?

A Yes.

Q I really was questioning what was the occasion for saying "Bishop will be informed that the firm's current capital position still requires emergency measures to keep under 2,000 per cent"?

A Mr. Spies, Mr. Newman, Mr. Jolonz, the examiners department were all aware of which firms were involved in the capital ratio problems, and when these papers came in I would check with probably Mr. Spies to find out is it still necessary to get additional emergency capital for the firm.

Q And I gather he told you it was?

A Yes.

Q Because without the capital it was over 2,000 per cent?

A I didn't say that.

Q I am asking that.

A It may not have been. The exchange was working on the basis of a 1,500 per cent, that's when they begin to look very carefully at firms.

Q Sir, the end of this very short sentence says

"Still requires emergency measures to keep under 2,000 per cent."

A That's correct.

Q In this case it did need the capital to stay under 2,000?

A That's what it says.

Q And that was right, wasn't it?

A You are trying to get me to say did I make a determination that a firm is in capital violation? I don't.

THE COURT: I sustain the objection. We are clear as to what the standards are from a number of witnesses at this point.

Q Did you inform or take any steps to inform the lenders who were getting this emergency approval that they were getting emergency apprvoal?

MR. BROOKS: I object. There is no identification of lenders here. It is not even clear how this money is coming in.

THE COURT: I think that's implicit in this memorandum. There isn't a foundation for getting downto the exact numbers so far.

MR. BEEBE: I am not trying to do anything more than what the procedure was to inform people as to what the witness was informing Mr. Bishop.

THE COURT: You have to get down to identification of who the people are in some manner.

Q Where was this emergency capital coming from? Not necessarily the names of the people but just the source of the funds.

A I have no idea.

Q Was it coming from outside the --

A I have no idea.

Q I show you a document marked previously 46 for identification.

Was this the kind of summary that you or your group would prepare on problem firms?

A Yes.

Q And on the upper left-hand corner are those your initials? I think the only copy that is really legible I have handed to his Honor. I am not sure that it is legible on your copy.

THE COURT: He may use it.

Q Let's use that as the exhibit then. Those are your initials up at the corner, aren't they?

A Yes.

Q What was the occasion for preparing this -- well, you have answered that.

What is the usual method of preparing this kind

of summary at that time?

A For preparation of the group that worked with me in reviewing a firm with the staff that were in charge of the overall coordinator's program and in preparation for the appearance of the firm's officers to discuss some problem.

Q So this was prepared by or for you in that connection; is that right?

A Right.

MR. BEEBE: I offer that as the next exhibit in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 46 received in evidence.)

MR. BROOKS: May we inquire whether the attached schedules were part of the memorandum when it was prepared?

Q Or are they back up that were prepared at the same time by way of exhibits or what have you to the memorandum?

A These papers I have never seen before.

Q These are not part of the usual procedure in connection with this kind of memorandum?

A No.

THE COURT: Let's take them off then.

(Pause)

Q Sir, yesterday you testified about two chronologies that you prepared, one October 28, '68, which I think is marked 33A, and another one attached to your memorandum from Mr. Bishop to you which is marked 35A. That was dated November 7, 1968.

In Mr. Bishop's memorandum, he says, "Please give me a report on how the latest information we have looks in comparison with the firm in which we restricted them," which I believe is April, 1968.

A That's correct.

Q How did the latest information look as of November, 1968, in comparison with the April, 1968, period?

MR. BROOKS: Your Honor, we testified about this yesterday. It is explained in the next note on the document. I see no reason to go over it again.

MR. BEEBE: I object to this interruption. This question was not asked and answered at all yesterday.

MR. BROOKS: We covered it.

THE COURT: Come around to the side bar.

(At the side bar.)

MR. BROOKS: We had testimony about the message and the reply.

MR. BEEBE: And the relly didn't give an answer. That's why I am asking the question. I should be allowed to

pursue lines of inquiry without having a man be led into answer in the document, as if that's the only answer in the world. I think the answers on the stand as to a man's knowledge are what matters.

MR. BROOKS: I'm sure his knowledge is going to relate what's in the document.

THE COURT: We did go over this exhibit yesterday.

MR. BEEBE: Not this one. It is very important. It shows things were much worse but they imposed no restrictions. It is as simple as that. He didn't give a report. He said let's wait and he waited and waited.

THE COURT: When you ask him whether he knows anything beyond what is in this memorandum.

MR. BEEBE: I know what the answer will be, sir. In all cases.

THE COURT: Do you believe that today seven years later he is going to have any substantial recollection independently of these memoranda?

MR. BEEBE: I think a man who is strongly suggesting and urging his bosses that people be put on violations, certainly with his recollection refreshed, as it has been, will remember that things were much worse than they were in April. The question raised is why. He can't answer that question but the other witnesses can.

MR. BROOKS: I don't think he urged restrictions in this period. This is a date of November, '68.

MR. BEEBE: He did testify yesterday that he did urge restrictions in late '68.

MR. BROOKS: The evidence will show that it's been '69.

MR. BEEBE: We should let the witness testify and not have counsel testifying.

THE COURT: I don't think counsel was testifying. But explore it in the interests of saving time because if he doesn't have a recollection, there is no point in having you read a piece of it and him saying that's what the memorandum shows or that's what the letter says because we can use ions of time and we haven't got that time.

Go at it as short as possible.

(In open court.)

THE COURT: Let's have the question read back. Objection is overruled.

(Question read)

A As I indicated yesterday, the firms operating position improved from April forward and then started to deteriorate again towards November.

Q So that by November it was in worse shape than it had been in April.

MR. BROOKS: I object to the question, your Honor. It's leading.

THE COURT: It's leading in form but let's see what the answer is. Overruled.

A Its ability to handle the paperwork problems was deteriorating again.

Q Sir, turning to this summary, I'd like to read some passages from it. This is a chronologoy, isn't it, of what has happened in the past year?

A Yes.

Q And bringing everything up to date?

A That's correct.

Q I think we went over 1968 pretty thoroughly. Let's start -- although there may be more on it, but I will start for this purpose with January 9, 1969. This is on page 3.

"HES memo," that's your memo that we marked in evidence. "Firm needs 1.7 million to meet 2000 ratio,

and 2.3 million to meet 1500 per cent ratio."

Then it skips on, "Firm currently raising 1.2 million in capital."

MR. BROOKS: Your Honor, I would like to correct the reading. Mr. Beebe gave a January 9th date andthen read the information opposite the January 13th date.

MR. BEEBE: Thank you, Mr. Brooks. You are right.

Q Let me go back to January 9th.

"HES memo, firm will be late in filing answers to RFQ and will probably be in capital violation as of October 31, 1968."

This is January 13th which I just read.

January 28th, "HES memo, ratio of AI to NC 3,992 per cent, charging shorts, without charging shorts ratio was 2717 per cent."

MR. BROOKS: Your Honor, I am going to object to the reading of the chronology because it is simply a cumulative recitation of the actual evidence which was admitted yesterday. I see no reason to do it again.

MR. BEEBE: It's in evidence, sir, and it brings up to date what this witness and the exchange had. It's only going to take a minute.

THE COURT: Are you putting any questions to him based on this reading because this is, I gather, a capsulization of Exhibit 36.

MR. BEEBE: Of various exhibits, sir. Some of them, yes. But it says it in a much more succinct form based on the witness' testimony this morning that these were only apparent violations.

THE COURT: I know, but this exhibit is in evidence, this last one.

MR. BEEBE: Yes, sir. I would like to get these particular facts in front of the jury.

THE COURT: Then why don't you mark what you want to read to the jury, read it to the jury and we will have been done with it.

MR. BEEBE: Yes, sir, this has been marked, sir.

THE COURT: Say to the jury, "Ladies and gentlemen, I am going to read from exhibit" so and so and you read what you want to read and then we are finished.

MR. BEEBE: I shall do so.

We have up to January 28th now. The next entry is January 29th. On January 29th, "Firm met with exchange staff to determine amount of capital needed.

Firm agreed to file amended answers and obtain new capital of $500,000 by January 31, 1969, $2,083,000 or a reduction in shorts by the end of February."

MR. BROOKS: Your Honor, there is a hand-written amendment in that sentence. I'm not sure that I can read it, but it may be Mr. Beebe can. We should note that it does appear.

MR. BEEBE: I believe that pertains to the deadline being extended to one week later.

MR. BROOKS: It says something else, too.

(Pause)

THE COURT: It reads "One week thereafter at 300,000."

MR. BEEBE: On January 28, 1969, "Firm sent letter to exchange explaining capital problems and operation deterioration. Firm's figure showed 3.084 million needed to reach 2000 per cent or 4.647 million needed to reach 1500 per cent."

Further down that page, "Firm's January SOO showed reduction in SR differences, customers' unsecured accounts and suspense account items but differences account items were up as were non-current dividend items. The firm reported a capital ratio of 1979 per cent."

Finally, on March 18, "The exchange informed the firm that the SFQ as of January 31, 1969, showed a ratio of 2981 per cent; therefore, 325 violation again."

The last entry, "HES memo, March 27, 1969, HES talked to firm. It appears that firm has probably been in capital violation from October 31, 1968 to January 31, 1969."

Q I do have a question for you, sir, after reading this, and that is on January 28, 1969, or within a short time thereafter,and I will define that as two weeks, three weeks, did the stock exchange impose restrictions on McDonnell & Company?

A What were the dates on that, please?

THE COURT: January 28 and three weeks thereafter.

A No.

Q Now, we have already marked in evidence a few days ago a memorandum dated March 28, 1969, and that is Exhibit 21.

Q Sir, yesterday there was some questioning and testimony about the relationship between net capital violations and the firm's financial condition. Just to refresh your recollection on this subject, I would like to read you the third paragraph of this memo.

"SR shorts, short dividends, and non-current cash dividends are hurting the firm's capital."

Your initials are up on the corner of that and you are mentioned as attending this meeting. So can I ask you what was the firm's capital that was referred to in this paragraph?

A I didn't write this memo.

Q I appreciate that, sir. But I believe --

A We are talking about the capital ratio.

Q The next sentence reads, "The examiners also noted that the figures given by the firm in its SOQ's are suspect."

Were they suspect, as I just read from the chronology of March 28th, in part because the January SOQ, January 30th SOQ from the firm showed a ratio of 1979 per cent but the exchange's analysis of the same figure showed a ratio of 2981 per cent?

MR. BROOKS: I object to the question.

THE COURT: Yes, sustained.

Q Why were they suspect, sir?

MR. BROOKS: I object to the question again. The witness hasn't agreed that they are suspect. He didn't write the memo, he is not the examiner to whom the memo refers as the speaker.

THE COURT: Sustained at this point.

Q Were you present at that meeting, sir?

A Yes, sir.

Q Did you hear the examiner's note that the figures were suspect?

A I don't recall the word "suspect."

Q As you sit here now do you recall the figures given by the firm at that time were suspect?

A I think the contention always has been that it's been difficult on the basis of their records to determine what their capital position was or capital condition or ratio was.

Q So at that time you did have some doubts about the accuracy of their figures; is that fair to say?

MR. BROOKS: I object.

THE COURT: Overruled.

A I would say it's a reasonable conclusion.

Q It's a reasonable conclusion; is that what you said, sir? I didn't hear you.

A Yes.

THE COURT: A rasonable conclusion to have doubts about the accuracy depicted. Is that what the answer amounts to?

THE WITNESS: Yes.

Q Now, did there come a time shortly thereafter --

THE COURT: Gentlemen, let me bring you to the side bar again, please.

(At the side bar)

THE COURT: Mr. Beebe, I don't want to do this in the presence of the jury and I regret taking the time to do it now. But what do you get from that last series of answers that you didn't have already from the memo?

MR. BEEBE: Mr. McElroy and this witness both -- I find it's necessary to try to establish to the jury that they were finding and doubting the figures, but they weren't doing anything about it.

THE COURT: You have that in a contemporaneous memoranda. What did you get from this gentleman that added to that?

MR. BEEBE: Very little.

THE COURT: As I say, I don't want to start cutting in with the jury because then they might feel that I think something is irrelevant and that's not fair to do that. But I do submit that when you have a sentence like this, your record is made.

MR. BEEBE: Stick with the sentence, all

right.

THE COURT: Go on to something else.

MR. BEEBE: May I say at this point, sir, that I think that all counsel, and of course the Court, are well aware of where we are going and what we are trying to prove and perhaps can foresee a little bit of the line of questioning, and so on. I think for the jurors, we have eight jurors who are not as familiar, even with the court procedure, and that it takes a little time to educate them and sometimes it may be difficult for counsel and the Court to understand that I have to go over things slowly. I apologize for that.

THE COURT: Don't apologize. If you have a memo, read the memo and let's go on. For example, you asked the gentleman, were restrictions imposed in a particular pair of months, and he doesn't really know at this point but I take it that that fact can be stipulated.

MR. BROOKS: That is right.

THE COURT: They can stipulate that they didn't impose restrictions at such and such a point.

MR. BEEBE: I hesitate to turn to a guy and say in open court, "Will you stipulate to that?"

THE COURT: You can do it at the recess and

be governed accordingly. This gentleman seven years after, he probably doesn't remember whether it's this month or that month or whatever.

I'm sure Mr. Brooks will say to you that I am prepared to tell you we did this on this date and that on the other date.

MR. BROOKS: The firm in January agreed to a whole set of self imposed restrictions.

MR. BEEBE: Which were obviously unsatisfactory.

THE COURT: I am trying, as you can see, desperately to get this case down to a reasonable time and let you have the record that you want to make. We are going over a lot of things where your record is made, the facts are in, and you can make the jury argument you want to make. The problem is if we go too far, as a matter of discretion I am going to have to start cutting things off.

MR. BEEBE: I'll try not to go too far. Convincing the jury is my main objective.

THE COURT: All right.

(In open court)

MR. BEEBE: I offer 48 in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 49 was received in evidence)

MR. BEEBE: I would like to read that to the jury.

This is from Mr. Schuette to Mr. Bishop. McDonnell & Company, meeting April 2, 1969, 2 p.m. It's dated April 1, 1969.

"Here is a small package of material summarizing the main problems at McDonnell. It would appear that the basic trouble lies in the general record keeping which is in such a condition that the firm would appear unable to compute an accurate capital position.

"It would also appear that this situation has existed for several months now with no real signs of improvement."

Q You delivered that to Mr. Bishop on that day, didn't you?

A That's correct.

Q Do you remember the meeting the next day with Mr. Bishop?

A I don't recall that I attended the meeting.

Q Let me show you Exhibit 23, which has been

previously marked in evidence, and ask if that refreshes your recollection.

A Yes, it does.

Q Did you attend the meeting then?

A Yes, sir.

Q Have you had a chance to go over that copy of that before today's session?

A Yes, I have.

Q Is everything that happened at the meeting contained in that memo?

A There were two meetings; which meeting are you discussing?

Q Both, if that will speed things up.

A I attended only one of the meetings.

Q At the bottom it says "A subsequent meeting held by FS, and so on, and HES explored possible restrictions to be recommended to the committee."

A That's correct.

Q Did you attend that meeting?

A Yes, sir.

Q On top it says "Two separate meetings and then a combined meeting in RMB's office today" --

A I am sorry, I remember now I was at both meetings.

Q Can you tell us what happened at the meetings if it's not all reflected in here?

A The first meeting was in Mr. Bishop's office with the persons indicated here present, including the officers of McDonnell & Company, and the thing that comes to my mind about the meeting was a general discussion about the fact that Larry O'Brien was brought into the firm and he should give some prestige to Wall Street.

Q Do you remember anything about obtaining capital, being placed on restrictions?

A There was very little discussion at that meeting.

Q What was the purpose of the meeting?

A The rest of us adjourned to the second meeting. I believe Mr. Bishop, Mr. O'Brien, Mr. Rome, Mr. Jaeger, and Mr. McDonnell, continued the meeting.

Q What was the purpose of the adjourned session, those of you who left the meeting?

A To take a look at what kindof restrictions possibly should be imposed upon the firm.

Q Who directed you to go out and do that, if anyone?

A Mr. Bishop, I assume.

Q And were these the proposals you explored that are listed down at the bottom of the page?

A Yes, they are.

Q As a result of that were restrictions imposed?

A Subsequently, yes, that I know of.

Q How soon after April 2, 1969?

A I don't recall.

Q Two months?

A I dont know.

Q One of the restrictions listed is No. 5, knowledgeability letters. Will you explain how knowledgeability letters constitute a restriction?

THE COURT: Sustained. We went through this, I think, with another witness. This is cumulative.

MR. BEEBE: I think the other witness didn't know, sir, but I will go on.

Q Did you report back after that session afterwards about your recommendations on restrictions?

A Yes, I did.

Q Who did you report to?

A Mr. Stock.

Q Was there another meeting the next day --

MR. BEEBE: I offer in evidence, I believe there is no objection, a memorandum dated April 3, 1969.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 50 was received in evidence)

Q Are those your initials in the upper lefthand corner?

A Yes.

Q Did you attend that meeting the next day?

A Yes.

MR. BEEBE: I would like to read this.

(Mr. Beebe read to the jury from Plaintiffs' Exhibit 50 in evidence)

Q Did anything occur at that meeting that is not recorded in that exhibit?

A I don't recall.

Q In preparation for the January 28th meeting I believe your memorandum, Plaintiffs' Exhibit 39, you wrote the word "charged" next to the short record differences, is that right?

A That's correct.

Q Is a charge the opposite of allowing something?

A I assume so, yes.

Q Is that consistent with Exhibit 40 which says in the middle of the paragraph "According to McKay, the exchange permitted the exclusion of stock dividend shorts"--

MR. BROOKS: I object. The question of whether it is consistent. The memorandum.

THE COURT: Sustained.

Q Can you explain to the jury, are both of these the same, saying the same thing, about the treatment of stock record differences?

MR. BROOKS: I object again. Yesterday Mr. Schuette testified he wrote the word charged down there because an examiner told him over the phone that is how they proceeded.

MR. BEEBE: That is what I am getting at. This

appears to be exactly the opposite of what they were told.

MR. BROOKS: It is three months later.

MR. BEEBE: Exactly the same date.

THE COURT: Let's get the facts and we can argue the relationship at a later time.

Q Could you tell us in a neutral way, sir, is a charge the opposite of an exclusion?

A Yes, it is.

Q What was the purpose of this meeting on April 3, 1969?

A To explore the problems with the operating officers of the firm, to get the examiners' discussions of what they apparently found, and to indicate to the firm that there were going to be restrictions placed upon them.

Q Would it be fair to say that one of the purposes was to find a way to bring them under the net capital rule level?

MR. BROOKS: Your Honor, I object. The memo sets out that they are under the capital requirement at the time it is written.

MR. BEEBE: Your Honor, I would like a chance just to get out what the witness' views are on this, and also the facts at that time, and I don't think that an argument about what this memo says or doesn't say moves us along

very far.

THE COURT: Let me hear the question again.

MR. BROOKS: The witness has testified that everything he recalls about this meeting is in the memo. The memo says that they are under the requirement.

MR. BEEBE: On the basis of a lot of pushing around of numbers, that's right, and that's my question.

THE COURT: This is all argument at this point. Read the question.

(Question read.)

THE COURT: I am going to sustain an objection to the form of the question.

MR. BEEBE: Then I will come back to that.

Q Did you have any discussion at that period of time that you participated in at the exchange about suspending McDonnell & Company?

A No, I did not.

Q Was there any discussion that you heard of or knew of at the exchange on that subject?

A None that I recall.

Q What about the subject of consideration of fining McDonnell & Company?

A I don't recall.

Q Do you recall any discussion of bringing charges

as of the beginning of April, 1969?

A I don't specifically recall.

Q If I didn't limit it to the beginning of April, but that whole span of time, January to, say, May, 1969, do you recall any discussion of charges at that time being brought against McDonnell & Company?

A Mr. Beebe, I no longer performed as a coordinator after April 8th. So I was no longer involved directly in a lot of the things that were going on with McDonnell & Company.

Q Aside from that, sir, you stayed with the exchange until May 8th, and performed liaison functions with the new coordinator, Mr. Newman, is that right?

A That's correct.

Q So did you hear any discussions during that--

A I don't recall.

MR. BEEBE: I offer in evidence a document which has been marked Exhibit 51 for identification.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 51 received in evidence.)

MR. BEEBE: It indicates that it is a draft dated April 7, 1969.

Q Was this your draft of the restrictions letter, sir?

A It certainly reads like it was.

Q It has your initials up in the upper left-hand corner, doesn't it?

A As I indicated, Mr. Beebe, my initials in that left-hand corner indicated that I read it, that I know what it is about, and that it should be placed in the McDonnell Company file.

Q I may have misled you, sir, I'm sorry. The upper left-hand typed portion.

A Yes, sir.

Q That indicates it was prepared by you?

A Yes, sir.

Q You are right, there are other initials up there.

Was this the draft restrictions letter that emanated from that discussion on April 1st or 2nd?

A It was.

Q Had Mr. Bishop requested that you prepare this?

A Mr. Stock.

Q Mr. Stock?

A Yes.

Q Is it fair to say that the first page covered generally imposing specific limitations relating to the firm's operating conditions, and the second page covered the firm's capital conditions?

MR. BROOKS: Your Honor, I object.

THE COURT: Sustained.

MR. BROOKS: I think I would also object to further query about this, unless we find out what was sent. This is just a draft. I don't see what the purpose is.

THE COURT: Let's see what the questions are.

Q Mr. Schuette, on the second page I would like to read something to the jury. The first full paragraph. "Because of the questions that have arisen concerning the computation of the firm's capital condition and the requirement to comply with Rule 325 at all times, we feel that there is an immediate need to obtain approximately $2,000,000 to keep the ratio well below 2,000 per cent. Such an addition in capital should be made by" -- and then there is a blank space.

Q Sir, could you explain what was to be filled in the blank space?

A A date.

Q Who was to fill it in?

A Mr. Stock, I assume.

Q So you did deliver this to Mr. Stock?

A I don't recall.

Q Am I correct that there is no mention in here about alerting anyone from whom this additional two million dollars might be raised from about the firm's capital or

operating conditions?

MR. LOFLIN: I object, your Honor. The document speaks for itself.

THE COURT: Sustained.

MR. BEEBE: I will read the whole document then, and not read what I have already read.

THE COURT: Mr. Beebe, you can argue to the jury at an appropriate time.

MR. BEEBE: Very rwell, your Honor. I will adopt that suggestion.

THE COURT: Ladies and gentlemen, we will take our mid-morning recess.

(Recess)

rdh 1 Schuette-direct

(In open court, jury present.)

MR. BEEBE: The next exhibit is 52. I believe there is no objection. I offer it in evidence.

(Plaintiffs' Exhibit 52 received in evidence.)

Q Sir, I have handed you Exhibit 52 which was just marked. I would like to turn back to the last exhibit for one moment.

MR. BROOKS: Your Honor, we have some confusion. When the plaintiffs asked us whether we would object to Exhibit 52 coming in,we did so on the basis of the fact that at the deposition our records reflectted that it was a one page exhibit. And we admitted in a demand to admit to a one page exhibit.

Exhibit 52 which has come in has many pages to it. In fact, some of them are different letters back and forth to different people. This is the first time that we are aware of these, as far as I know.

MR. BEEBE: I don't think it is the first time, your Honor. These were subpoenaed from the stock exchange. These are attachments to the famous Exhibit 66. Do you remember, Mr. Brooks? And these are the ones that were produced by the stock exchange in response to that subpoena.

MR. BROOKS: That may be, but we have no objection to page 1 coming in, which was the deposition exhibit that

we admitted was genuine and part of the business records.

There is no such admission to the other pages, and I think Mr. Beebe should therefore lay a foundation, if he can, for those.

THE COURT: Just hold up a minute.

(Pause)

MR. BROOKS: In fact, some of them appear to be internal McDonnell & Company documents.

MR. BEEBE: Could I call for the subpoenaed document?

THE COURT: The second sheet appears to be referred in the first sheet. As does the last two sheets, which is Exhibit 51 as a matter of fact.

MR. BROOKS: The last two sheets were the most recent exhibit, 51.

THE COURT: That's right. The second sheet appears to be referred to in the first.

MR. BROOKS: Agree with that.

THE COURT: Now, the rest of it I do not see at this point see how it becomes a part of this exhibit.

MR. BEEBE: I can explain it very simply, sir. It was produced in response to a subpoena by the stock exchange and I simply turned around and copied it.

THE COURT: That may be.

MR. BEEBE: I'm very sure that this was exactly the way it came in. Perhaps we could clear it up if the subpoenaed document were produced at this point.

THE COURT: I will tell you what, I am going to exclude the middle three pages at this point unless this witness is prepared to give you some sponsorship for them.

MR. BEEBE: Before we tear it apart could I try to get some sponsorship?

THE COURT: Please do.

Q Mr. Schuette, did you forward some material to Mr. Stock needed for the discussion with Murray McDonnell in and about April, 1969?

A Yes.

Q Will you look at the attachments here and focus particularly starting on the third page with a letter from Murray McDonnell addressed to Mr. Bishop, dated April 7th, and the fourth page and the fifth page and the sixth page -- I'm sorry, the fourth and fifth page, which appears to be a memorandum on mandatory restrictions, also dated April 7th. I ask you if those documents were attached as part of the package that you sent to Mr. Stock?

A Except for the first two pages, the rest of the package is not part of the memorandum.

MR. BEEBE: I call for the attachments to Exhibit 66

which are the subject of the trial subpoena.

MR. BROOKS: Our search did not reveal any exhibits attached to Exhibit 66 or described.

THE COURT: Let's go forward at this point and I will admit the first two pages as Exhibit 52 in evidence. I will exclude the balance and you can try to resolve this over the lunch hour.

MR. BEEBE: Very well, your Honor.

THE COURT: These other two pages may be marked 52A for identification.

MR. BEEBE: May I make one suggestion? The covering memo refers to a draft letter suggesting appropriate restrictions as discussed with Fred Stock.

THE WITNESS: Then I will probably withdraw what I said. Maybe the last two pages of the draft were included in that.

MR. BEEBE: Could we make the exhibit, if there is no objection, the McDonnell's supposed self-imposed restrictions and the draft letter?

THE COURT: You may.

MR. BROOKS: No objection.

THE COURT: The April 7th submissions of McDonnell & Company will be marked 52A for identification.

(Plaintiffs' Exhibit 52 received in evidence.)

(Plaintiffs' Exhibit 52A marked for identification.)

Q Now, when you forwarded these materials that are 52, the ones that you have identified, to Mr. Stock, do you know what he did with them?

A I have no idea.

Q The last paragraph on the forwarding memo says--let me pull back.

Was the subject of this memo the proposed imposition of restrictions?

MR. BROOKS: I object. It is perfectly clear from the memo what the subject is.

THE COURT: Yes, sustained.

MR. BEEBE: May I read from the memo?

THE COURT: Yes.

Q Apparently from you to Mr. Stock, McDonnell & Company restrictions.

(Plaintiffs' Exhibit 52 in evidence read to the jury.)

Q Did you receive that call?

A Yes.

Q What did McKay tell you?

A I don't specifically recall.

Q Do you recall generally, sir?

A Generally, he indicated they were going to contest

the restrictions.

Q What was the basis for the contest?

A I don't recall whether he mentioned it.

Q Did you at that time hear any basis, hear about any basis for contesting the restrictions?

A I don't recall..

Q The bottom is a note in your handwriting, is it not

A Yes.

Q I will read it to the jury. It is dated April 17, 1969. "Meeting of RMB and Stock and Murray McDonnell. No restrictions imposed."

That's your signature at the bottom?

A My initials, yes.

Q How did you learn that, no restrictions had been imposed?

A My assistant coordinator continued to perform as assistant coordinator to Mr. Newman who succeeeed me as coordinator, and we were gradually turning over all the firm files to Mr. Newman.

Q So you learned that from your assistant coordinator?

A Yes.

Q Who was he?

A Peter Naliwick,N-a-l-i-w-i-c-k.

Q Did you learn from Mr. Naliwick or anyone else what the basis was for not imposing the restrictions?

A I don't recall.

MR. BROOKS: Your Honor, on the basis of the foundation Mr. Beebe has laid in conjunction with the reading of the last paragraph of Exhibit 52 and the witness' answers, I will withdraw any objection that I have to Plaintiffs' Exhibit 52A. It may come in in evidence.

THE COURT: All right.

(Plaintiffs' Exhibit 52A received in evidence.)

Q Could you look at 52A, please, for a moment, sir, the first letter, and I would like to ask you if you have ever seen that before?

A No, I have not.

Q Have you seen the memorandum that constitutes the second and third page?

A I have not.

MR. BEEBE: I would like to read just from the covering letter from Mr. McDonnel to Mr. Bishop, Murray McDonnell, vice president of the Department of Member Firms.

April 7, 1969 "Gentlemen: We request a delay of three months in the imposition of restrictions for McDonnell & Company, Incorporated for the reasons set forth in the attached memorandum. If such a request is

denied we ask that the matter be appealed to the highest authorities of the New York Stock Exchange."

Sir, what is the effect of imposing mandatory restrictions in terms of publicity about the firm?

MR. BROOKS: I object to the question.

THE COURT: Yes, sustained.

Q Are the voluntary restrictions public knowledge?

A No.

Q Do mandatory restrictions become known within the membership organization?

A Yes.

MR. BROOKS: I object to the question. How could he answer that?

MR. BEEBE: Did he answer it?

THE COURT: I know, but what is the basis for his knowledge?

MR. BEEBE: His experience from many years in the stock exchange as to how these things work so the jury can see what the effect is of imposing or not imposing.

THE COURT: No, let's get the answer from the witness, not from you.

THE WITNESS: Would you please ask the question again.

MR. BEEBE: I believe we had an answer on the record.

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THE COURT: I know we did but I am questioning whether the answer was a knowledgeable and helpful answer to the court.

(Question and answer read.)

THE COURT: I will allow it to stand.

Q And does that result in defections of personnel in the member organization?

THE COURT: If you know.

A I don't think I can answer that positively what the results are.

Q I would like to read from one portions of the attached memorandum from the McDonnell Company to the stock exchange asking for the extension of three months on the imposition of mandatory restrictions.

Paragraph 7.

"The imposition" --

MR. BROOKS: Excuse me, Mr. Beebe. I'm not sure, your Honor, that the memorandum was attached to the letter to the stock exchange. It is not referred to in the letter. It is just a separate memorandum. It appears to be an internal memorandum of McDonnell & Company.

MR. BEEBE: Could I please read from the covering memorandum, sir?

THE COURT: Look at 58A, sheet 1, the first

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paragraph.

MR. BEEBE: I think it is just the contrary.

MR. BROOKS: I will correct it, your Honor. I apologize to you and Mr. Beebe.

THE COURT: Read paragraph 7 of the April 7th memorandum of McDonnell & Company, please.

MR. BEEBE: Thank you, sir.

"The imposition of mandatory restrictions at this time, since the fact cannot be concealed within our organization, could start defections of personnel which could threaten the continued existence of the firm and the possible forced abandonment of our new securities processing system, which is the first revolutionary and complete processing system ever designed."

Q Now, coming back to your draft restrictions letter, one question was suggested as to whether this actually ever became a final restrictions letter. Let me ask you something first. On the second page, second full paragraph, I will just read from that. It says, "In view of the questions still open about the firm's capital, each new capital contributor must sign a knowledgeability letter similar to the enclosed example. Stockholders making capital renewals must also supply the exchange with such a letter."

Was that restriction letter finalized and sent out?

A I have no knowledge.

Q When it refers in that sentence to the question still open about the firm's capital, each new capital contributor must sign a knowledgeability letter, is the capital that is referred to there the financial capital of the firm as opposed to -- what is the capital that is refefred to there?

A The money contributed by new stockholders, old stockholders, customers who become subordinated lenders.

Q Finally, sir, coming back to the January 29, 1969, meeting, which you testified yesterday about in your direct examination, you said, in answer to a question about relating for us what the discussion was with Mr. Bishop, "Specifically Mr. Bishop came into the room and indicated to the officers of McDonnell & Company that they had to raise a specified amount of capital by such and such a date."

"Q Then did he leave?

"A Then he left."

When you say "indicated" in there, can you relate for us, with as much precision as you can, what he said?

A I don't specifically recall his words, exact words.

Q Did he come in and stand behind a chair and simply make an announcement; do you recall that?

A That's substantially what happened, yes.

Q Was anything said by the McDonnell & Company people after he made his announcement?

A I don't recall.

MR. BEEBE: No further questions on direct of this witness.

CROSS EXAMINATION

BY MR. BROOKS:

Q Mr. Scheutte, how many firms in the MNOP group of firms were there overwhich you had jurisdiction as a coordinator in and about February of 1969?

A Somewhere between 106 and 108 firms.

Q Now, did some of these other firms beside McDonnell have problems generated by the paperwork crunch similar to those of McDonnell?

A Yes.

MR. BEEBE: Objection.

THE COURT: Overruled.

Q By that time referring to problems such as stock record differences, fails, capital ratio problems.

A Yes.

Q Now, do you find it sometimes difficult to keep in mind six years later the precise details as to one of those firms when you are asked questions about those details?

A Very difficult.

Q Let me see if you have this in mind, Mr. Schuette. Any time when you were functioning at the stock exchange and had jurisdiction over McDonnell & Company, did anyone ever tell you in writing or orally to treat McDonnell any better or any worse than you treated t-ose other hundred or so firms?

A No,sir.

Q You testified that you recommended imposing restrictions, and this was yesterday's testimony, probably late in 1968 or early in 1969.

After reviewing these recent exhibits which you have seen reflecting discussion about restrictions and a meeting in early April, is your recollection refreshed that your recommendation was in early '69, to wit, in and about April?

A It seemed to me it was earlier than that.

Q How much earlier?

A Probably around the time we got into the discussion or the discussions were going on about the capital computations.

Q About January?

A January, February.

Q Now, in and about that time do you recall McDonnell & Company volunteering that it would follow and abide by a number of self imposed restrictions?

A Yes.

Q In and about January?

A Yes.

Q Now, I have here a letter which was marked as Deposition Exhibit 38. I only have one copy because

I didn't realize that this would become an issue. But I would like to show you that, a letter dated January 28, 1969, to the department of member firms, signed by Thomas A. McKay. I ask you if that letter sets forth McDonnell & Company's volunteering to follow a number of restrictions on their business and generally on their conduct which you recalled a minute ago?

A Yes, I do.

MR. BROOKS: I offer that, your Honor, in evidence. I will supply everyone copies if they don't have them already.

(Defendant Stock Exchange Exhibit BB1 was marked for identification)

MR. BEEBE: Is this being offered at this point?

MR. BROOKS: Yes, it is.

MR. BEEBE: May I take a look at it?

MR. BROOKS: Yes. (handing)

(Pause)

MR. BEEBE: This appears to be a letter from Mr. McKay to the stock exchange. I don't know if there is any connection with this witness.

MR. BROOKS: Why don't you ask him if he saw that before?

MR. BEEBE: Have you ever seen this before?

THE WITNESS: Yes, I have.

MR. BEEBE: When did you see it?

THE WITNESS: I don't recall.

MR. BEEBE: Did you see it recently?

THE WITNESS: Yes, I have.

MR. BEEBE: Did you see it at about the time of say April or March of 1969, do you recall that?

THE WITNESS: I recall seeing it right after, sometime in this period. End of January, early February.

MR. BEEBE: I have no objection.

THE COURT: Received.

(Defendant Stock Exchange Exhibit BB1 was received in evidence)

Q Now, Mr. Schuette, is volunteering for self imposed restrictions a normal practice by member firms at about this time when they were up against the wall?

A It happened very often, yes.

Q Do you know the reason why they would volunteer for self imposed restrictions when they were in a situation like this?

A Probably the stigma of forced restrictions caused them to become voluntary.

Q The letter, BB1, which has just been marked, recites that since October 28th, and I take it before -- since October 31, which was the date of the audit, and it must be prior to January 28, 1969, which was the date of the letter, the firm had increased its capital by certain designated amounts.

Now, do you recall that happening at the time?

A I don't recall.

Q Would you take a look at the exhibit and see if the recitation Mr. McKay set out in there refreshes your recollection?

MR. BEEBE: I think the exhibit speaks for itself, sir.

THE COURT: The question is whether with his recollection refreshed he will have answers to Mr. Brooks' forthcoming questions.

A I recall that capital was coming in.

Q That's before January 28th, I take it?

A Yes.

Q May I take a look at that?

A Yes. (handing)

Q Now, yesterday you testified that stock exchange rules required a member firm to have one box count a year. Do you recall that?

A Yes, sir.

Q And then you went on to answer a question of Mr. Beebe's, when he said "Then it's substantially correct that you can't calculate your capital unless you can count the box?"

And you answered, "Yes, that's substantially correct."

You didn't mean, did you, to say that if you simply conformed to the rule and counted your box the required one time a year that you couldn't calculate your capital during that year, could you?

MR. BEEBE: Objection. Leading and let let the witness testify himself what he means.

THE COURT: Well, this is cross-examination. Let me hear it back.

(Question and answer read)

THE COURT: I'll sustain the objection.

MR. BROOKS: I will read the exact testimony.

At page 835, your prior answer at line 12 was, "The fact that you are not counting the box doesn't mean it has any effect on the capital position at all. It's when there are differences in the count.

"Q In other words, if you can't count the box,

you can't compute the capital; is that correct?

"A That is substantially correct, yes, sir."

Q Now, my question is, did you mean by that answer to suggest that you couldn't calculate your capital if you conformed with the exchange rule and had only one count a year?

A You can certainly conform to the capital requirements or compute your capital ratios without counting the box. But specifically in terms of this particular audit, the count of the box was required.

Q And the box was counted by the auditors, was it not, in the course of their audit?

A I assume so, yes.

Q And would it, therefore, be fair to say that McDonnell & Company complied with the box count rule?

A Yes, sir.

Q Yesterday Mr. Beebe had marked in evidence Plaintiffs' Exhibit 34A, which is entitled "Operations check list, Securities and Exchange Commission national office," a date which appears to be 7-30 or 7-10-11-68, "McDonnell & Co., Incorporated."

I believe your first reactionyesterday was to identify this as a New York Stock Exchange

document.

I ask you to take a look at it and reflect on it a bit and tell me whether you can now identify it as something other than a stock exchange document.

A Yes, I can.

Q What can you identify it as?

A This is, as Mr. Beebe termed it, an operations check list of the Securities and Exchange Commission.

Q And how did you come to get it?

A I don't specifically recall.

Q But you did come to get it, I believe you testified.

A Yes.

Q Were you aware at this time that the Securities and Exchange Commission was conducting an examination of McDonnell & Company by the use of check lists such as that?

A Specifically, no.

Q Were you aware of the practice?

A The SEC was running a parallel operations questionnaire type of program.

Q On all member firms?

A I don't know what their policy was.

Q Does that document suggest to you that they

were running a parallel check on McDonnell & Company at about the time indicated on the document?

MR. BEEBE: Objection.

THE COURT: Sustained as to form.

Q Do you know whether the Securities and Exchange Commission was conducting an examination of McDonnell & Company in the fall of 1968?

A I do not know.

Q Does that document refresh your recollection?

A It doesn't refresh my recollection, although it may suggest it.

MR. BROOKS: Your Honor, I would like to read a few of the indications on this document, since it has been marked in evidence by the plaintiffs.

THE COURT: You may.

(Plaintiffs' Exhibit 34A in evidence was read to the jury)

Q Now, Mr. Schuette, let me show you what I have pre-marked as New York Stock Exchange Exhibit CC for identification. This is a letter or it appears to be a letter dated January 30, 1969 to the department of member firms of the New York Stock Exchange, signed by Thomas A. McKay.

I ask you if you saw this letter on or about

the date of January 30, 1969, which it bears.

A Yes.

MR. BROOKS: I would like to offer the letter in evidence and then read it.

MR. BEEBE: I believe it may already be in evidence. I have no objection to it going in, however.

(Defendant Stock Exchange Exhibit CC was received in evidence)

(Defendant Stock Exchange Exhibit CC was read to the jury)

Q Mr. Schuette, was your reading of this letter the first time that you had any knowledge that McDonnell & Company would attempt to satisfy its capital requirement by adding to the already subordinated accounts of Mrs. Anna McDonnell and Mrs. Marjorie F. McDonnell?

A Yes.

Q Do you know who Mrs. Marjorie F. McDonnell is?

A I have no idea.

Q Do you know who Mrs Anna McDonnell is?

A I have no idea.

Q The third paragraph speaks of a capital value of $950,000, and the paragraphs above speak of market values considerably in excess of $950,000.

Can you tell us what the difference is between capital value and market value?

A This tells me that they were subordinating securities in their personal -- in their accounts with the firm, and only a certain value can be attributed to these securities. They call it a haircut. They cut a portion of the value out because of the securities in there fluctuating up and down in the market so they provide, in a sense, a margin for fluctuation.

Q Do you recall how much that margin was?

A I don't recall.

Q Let's try to take a simple example for the jury. Let's say the haircut, as you called it, was 30 per cent, and I was putting in a million dollars of AT&T stock. How much capital value would the firm be allowed for my $1 million of AT&T stock?

A $700,000.

Q Because we haircut off the market value 30 per cent?

A That's correct.

Q Is that the process that was working here?

A Yes.

Q The letter advises that Mrs. Anna M. McDonnell and Marjorie F. McDonnell already had existing subordinated accounts. Does that then, that deposit that is described in the letter in each account, require any approval by the stock exchange, or does it require any approval of those two ladies?

A I assume it does, yes.

Q You assume it does?

A Yes.

Q Wouldn't they have first been approved when they opened those subordinated accounts sometime ago?

A Yes.

Q As I understand the procedure, what they are now doing is putting more assets in the account, is that right?

A Maybe I misunderstood your question.

Q Does that mean your answer is now different?

A Was your question would the two subordinated stockholders or lenders have to give approval for adding additional capital under the agreement? I said

yes.

Q I probably put my question inelegantly.

What I would like to know is: As I understand your past testimony, when someone wants to be a capital contributor to a firm they must get themselves approved, and that form goes to the secretary's office in the normal course, and then the board of governors determines whether it thinks the person is a person of high enough caliber to be approved or is not.

My question is: Did that approval have to take place in the case of an already existing subordinated account?

A No, it did not.

Q Would the procedure to be followed be simply like someone depositing more money in their savings account at the bank?

A More or less.

MR. BEEBE: Objection, your Honor, and I would like to have that stricken.

THE COURT: Yes, strike that out.

Q The last paragraph of the letter speaks of a commitment. Were you aware in and about this time of a commitment by T. Murray McDonnell to supply certain additional capital?

MR. BEEBE: Objection. I believe he said he had never seen this letter before.

MR. BROOKS: That is not correct at all. His initials happen to be in the upper righthand corner. I believe the witness testified thathe did see it on or about January 30.

THE COURT: Let's ask him. You saw this?

THE WITNESS: Yes.

Q Do you have the question in mind?

A Would you please repeat it.

Q Were you aware, in or about January 30, of a commitment that Mr. T. Murray McDonnell had made to the New York Stock Exchange to raise certain amounts of capital on a certain schedule?

A I don't specifically recall a commitment. I recall a demand by Mr. Bishop to bring this money in.

Q Is your testimony that you don't recall the response to that demand?

A I don't recall the response to it.

Q You were not then aware of a first requirement to deposit $500,000 on January 31 at this time, were you?

A This came out of the meeting, I believe,

at January 29. They required that the money be deposited.

Q You understand this to be meeting that requirement?

A That is what I understood it to be.

Q Do you understand that the contribution of January 30 simply meets the requirement for that day?

A I don't recall what the exact requirements were, so I couldn't answer that.

Q Mr. Schuette, you have looked at the SEC operations checklist which was marked in evidence by the plaintiffs?

I now show you a memorandum dated February 10, 1969, appearing to be signed by you, referring to some SEC activity, and I ask you if you can identify that. (handing to witness)

A Yes.

Q Are those your initials down at the bottom?

A Yes.

Q Are you the preparer of this memorandum?

A It's my customary language, yes.

MR. BROOKS: I offer it in evidence.

MR. BEEBE: On counsel's representation that this is previously produced I have no objection.

(Defendant New York Stock Exchange Exhibit CC1 was received in evidence)

Q Mr. Schuette, I think it fair to characterize the memo as saying that an SEC examiner has reviewed the analysis of a stock exchange examiner and has raised a question about the analysis. Is that a fair reading of it to you, sir?

A That's what it seems to say, yes, sir.

Q Do you recall the conversation which you had with Mr. Barton of the SEC about that subject?

A Specifically, no.

Q Was it a practice of the New York Stock Exchange to supply to SEC examiners the analysis made by stock exchange examiners of stock exchange member firms capital positions?

A I don't know whether it was policy and practice.

Q Do you recall it being done in respect to McDonnell & Company?

A Specifically, I don't recall.

Q Do you have any independent recollection of the event other than the exhibit before you?

A The second paragraph brings a vague recollection of standing in Mr. Schroeder's office and

discussing the allowability of customer cash accounts in this case, as discussed.

Q Do you recall whether that question had been raised by an SEC examiner?

A Yes.

Q You and Mr. Schroeder got together to discuss who was right, is that correct?

A No. I went to Mrs. Schroeder to get the expert's evaluation of the question.

Q Which expert?

MR. BEEBE: Expert's evaluation? I move to strike that,unless we have some testimony as to who is the expert he is talking about.

THE COURT: Strike it out.

Q You went to Mr. Schroeder to get whose evaluation?

A His evaluation of the question.

Q Do you recall what it was, what his evaluation was?

A He indicated that on strict -- special cash accounts that the unsettled debits in their regulation applied to those and therefore they were not charged against capital.

Q Was that the position he had previously

taken -- he, Mr. Schroeder, had previusly taken?

A I don't know the position he had previously taken on the question.

Q Was that a position previously taken by the exchange examiner's analysis?

A I would say yes.

Q Did you make any reply to Mr. Barton, the SEC accountant, after your discussion with Mr. Schroeder on this matter?

A Yes. I relayed the information.

Q To Mr. Barton?

A To Mr. Barton.

Q Do you recall what he said when you relayed it to him?

A I don't recall.

Q We talked about a demand that McDonnell & Company bring in additional capital in late January, and we have seen some documents that Mr. Beebe has showed you that indicated in late March or early April the firm of McDonnell & Company couldn't seem to quite secure its position under the capital rule, they were in and about 2000 per cent, as some memos showed, some above and some below.

MR. BEEBE: Objection. This is

characterization and mis-characterization, I might say.

THE COURT: Yes, sustained as to form.

Q Do you recall, Mr. Schuette, between the period of late March and early February the New York Stock Exchange rejected over a million dollars of capital that McDonnell & Company had brought into the firm?

A Yes, I do.

Q Do you recall the circumstances of that rejection by the stock exchange of the million dollars of capital?

A Yes, I do.

Q Would you tell the jury, please?

A The money was supposed to be coming from a trust, a Murray McDonnell or a McDonnell family trust, which had some clauses in it which the exchange wouldn't accept.

Q Do you recall what problem those clauses created and led to the exchange's rejection of this million dollars of capital?

A As I recall, they went to counsel about it.

Q Do you recall whether it had anything to do with the authority that the trustees had under the trust to make a loan such as the one being proposed?

A I am not familiar with the specifics of it.

Q Let me show you a memorandum that apparently was prepared by you dated March 6, 1969, which I have had marked as New York Stock Exchange Exhibit EE for identification.

I ask you if that memorandum is a description of the exchange's rejection of this capital that is offered by McDonnell & Company, or attempted to be brought in by McDonnell?

A Yes.

Q Do you recall who --

MR. BEEBE: Is this offered? I am sorry to interrupt, but I have no objection if it is being offered.

MR. BROOKS: You pushed me to it, Mr. Beebe. I will offer it.

(Defendant New York Stock Exchange Exhibit EE received in evidence.)

Q Do you recall who the trustees of this trust were, sir?

A It was one of the McDonnell ladies. I don't know which one.

Q One of the McDonnell what?

A One of the McDonnell ladies. I don't know which one.

Q Let me show you another letter which appears to refer to you, at least, and was addressed to the stock exchange, attention of Mr. Spies, from Thomas McKay, dated March 11, 1969, on the subject of the rejection of this capital by the exchange.

(Defendant New York Stock Exhibit EE-1 marked for identification.)

Q Would you read that quickly, sir? It is only a page.

A Do you want me to read it out loud?

Q No. I am going to ask you a few questions about it.

(Pause)

Does the Exhibit EE-1 refresh your recollection

as to who the trustees of this trust were?

A Yes, it does.

Q And now who do you recall to be the trustees?

A The Manufacturers Hanover Trust Company, and Mrs. Margie F. McDonnell.

Q The prior exhibit, II, recites in the last paragraph that "According to McKay, the firm's lawyers were meeting with Floyd Brandow to again discuss the exchange's objection to the trust agreement covering 1,075,000 in potential new capital."

Who was Mr. Brandow?

A I beliw he is a lawyer with your firm.

Q Exhibit EE-1 describes, or recites in the third paragraph, that Herbert E. Schuette has approved --

MR. BEEBE: Excuse me, I don't think this is in evidence.

MR. BROOKS: It is not yet in evidence.

MR. BEEBE: I object to reading from it.

MR. BROOKS: I was trying to get it in evidence.

THE COURT: Do you offer it?

MR. BROOKS: I wanted Mr. Schuette to give us-- tell us a little more about it, whether he saw it at the time.

THE COURT: Why don't you ask him?

Q Mr. Schuette, did you see the letter at the time?

A Yes.

MR. BROOKS: I will then offer it.

THE COURT: Any objection?

MR. BEEBE: No objection.

(Defendant New York Stock Exchange Exhibit EE-1 received in evidence.)

Q The letter has an attachment, sir, which is described as the estimated capital position of McDonnell & Company at March 3, 1969, showing two capital ratios, one of 1,890 per cent, and the other an alternative of 1,617 per cent, sir.

Was that attachment part of the letter that you saw at the time?

A I don't recall.

Q It is referred to, I believe, in paragraph 1 of the letter. Would it have been the practice of the exchange to keep the attachment with a letter such as this?

A Customarily.

MR. BROOKS: Any objection to the attachment, Mr. Beebe?

MR. BEEBE: I have no problem with it.

Q The third paragraph of the letter recites that "The enclosed computation does not include 600,000 of temporary capital deposited on March 10, 1969, in the

subordinated account of T. Murray McDonnell, with the approval of Mr. Herbert Schuette, nor the receipt to date of $237,,000 of capital from sale of additional McDonnell & Co., Incorporated stock, nor further decrease in capital penalties, nor $113,000 of additional capital to be realized from the sale of additional McDonnell & Co., Incorporated stock for which payment is expected momentarily."

I want to ask you some questions about that paragraph, sir. That's why I read it.

Do you recall giving an approval for this temporary $600,000 of capital?

A The word "temporary" bothers me, because I don't think temporary approval of capital is given.

Q I am not sure that the word "temporary" goes with approval. It seems to go with temporary capital.

A That's right.

Q Does that have any meaning to you?

A Capital contributed to a firm is not to be contributed on a temporary basis.

Q Do you have any recollection of a matter being discussed and resolved by you in or about this time relating to $600,000 of temporary capital?

A Yes. The firm was going to be a participant in an

underwriting, so in order to carry, to be adequately capitalized or financed, or to keep its ratio in line to carry the underwriting they needed additional capital. The question was: could they put in $600,000 temporarily? I discussed this with Mr. Bishop and I don't recall who else. The capital couldn't be put in temporarily, although they couldn't prevent a shareholder from taking his capital back out again if the capital ratioswere met.

In other words, it became temporary by the action of the shareholder.

Q Do you mean subordinated lender?

A Or subordinated lender.

Q While the $600,000 was in the account of Mr. T. Murray McDonnell, was it at the risk of the business of the firm, just as any other subordinated account was?

A Yes, it was.

Q Do you recall that this deposit was definitely made as it had been approved by you?

A Yes, I recall that.

Q Let me show you a letter I have pre-marked as Stock Exchange Exhibit FF and ask you if that letter from Mr. McKay to yourself documents the fact that that $600,000 was deposited?

A Yes, it does.

Q Does it document the terms under which it might be withdrawn?

A Yes, it does.

MR. BROOKS: I will offer that in evidence.

MR. BEEBE: On the representation this was previously produced I have no objection.

THE COURT: Very well.

(Defendant New York Stock Exchange Exhibit FF received in evidence.)

THE COURT: Mr. Brooks, will you be asking questions about this FF? If not, we will take our luncheon break.

MR. BROOKS: I would just like to read it.

(Mr. Brooks read to the jury from Defendant New York Stock Exchange Exhibit FF in evidence.)

Q Mr. Schuette, do you know whether they did withdraw their capital on or about April 1st?

A They did not.

MR. BROOKS: I think this would be a good breaking point.

THE COURT: We will take our luncheon recess until 2 o'clock.

(Recess to 2 P.M.)

AFTERNOON SESSION

2 P.M.

(In open court, jury present.)

H E R B E R T S C H U E T T E, resumed.

CROSS EXAMINATION CONTINUED

BY MR. BROOKS:

Q Mr. Schuette, Exhibit 51 is before you. That is the draft of the letter that you prepared as a suggested draft of a letter to be sent by Mr. Stock to Mr. McKay. Your draft is dated April 7th. I think Mr. Beebe established in your testimony that this draft was not sent, at least in April during the time that you remained at the exchange.

Do you recall whether Mr. Stock did send a letter on or about April 7th in response to the problems for which you suggested this draft which is Exhibit 51?

A I don't specifically recall.

Q Let me show you a series of documents which I have marked Stock Exchange Exhibit GG for identification and ask you if that series of documents refreshes your recollection.

A Yes, it does.

Q Can you tell me what your recollection is now about that subject?

A Mr. Stock sent me a memo asking that I prepare a letter to the firm outlining what the exchange wanted in terms of a program, improvement program by the firm in their operations.

Q Is the first document in the series of four pages which I have just handed you marked GG a memo Mr. Stock sent to you?

A Yes, it is.

Q And did you then pursue the task that he asked you to pursue?

A Yes, I did.

Q Is the second page an outline prepared by you in response to Mr. Stock's request?

A Yes, it is.

Q And if I were to characteize it, and did so, saying that it was a work plan, would that be consistent with your understanding?

A It was a work plan, yes.

Q Work plan for McDonnell & Company; is that right?

A For McDonnell & Company.

Q Take a look at the next two pages, sir. Can you identify those for me?

A They are the letter that Mr. Stock went out over his signature outlining the work plan.

MR. BROOKS: I offer this in evidence, your Honor.

MR. BEEBE: No objection.

(Defendant Stock Exchange Exhibit GG is received in evidence.)

Q Now, did you have any discussion with Mr. Stock about why he was going to send out a letter requiring a work plan from McDonnell & Company which is part of Exhibit GG, rather than sending out a letter of the type you had drafted, which is Exhibit 51?

A No discussion.

Q Do you know whether the decision to send out a letter in the form that is included in Exhibit GG rather than in the form that is Exhibit 51 was Mr. Stock's decision?

A I don't know whose decision it was.

Q Is the work plan that you outlined at Mr. Stock's request, which is part of Exhibit GG, a work plan that had been required of other member firms besides McDonnell in the past? By past I mean prior to April, '69.

MR. BEEBE: Objection relevancy.

THE COURT: No, I will overrule it. Although I must say your question is a little bit vague in form.

MR. BROOKS: I will restate the question.

THE COURT: I will sustain it on that ground.

Q Mr. Schuette, had the work plan, which is reflected in the second sheet of Exhibit GG, been applied or required in the past when you outlined it as to other member firms?

A Yes, the work plans were applied to the other member firms, not necessarily specifically these items.

Q But some of the items?

A Yes.

Q And were the items or the requirements of a particular work plan selected in response to the particular problems of the firm in question?

A Yes, they were.

Q Is there any requirement in the work plan which you outlined as to which the exchange had not had a prior experience in imposing and working with in respect to a member firm prior to it request that McDonnell submit such a work plan?

MR. BEEBE: Objection, your Honor.

THE COURT: Overruled.

A No, there is nothing unusual in here that hadn't been applied to some firm or another before.

Q Well, where did you come up with these points to include in your outline of a work plan?

A In a discussion with the examiner, I don't know

whether Mr. Spies was involved. It may well have been Mr. Spies also.

Q Do you recall the examiner with whom you discussed what work plan should be constructed for McDonnel & Co.?

A Yes, I do.

Q What was his name?

A He was the witness that preceded me. I am embarrassed that I can't remember the name.

Q Was it Mr. McElroy?

A Yes.

Q And did Mr. Stock's letter adopt the outline that you and Mr. McElroy and perhaps Mr. Spies had worked up?

THE COURT: Doesn't it speak for itself? You have the plan, you have the letter.

MR. BROOKS: I will withdraw the question.

Q Now, do you know whether McDonnell & Co. during your tenure at the exchange, and I know you understand we are now cutting into the last month of your employment there; but during that month do you know whether McDonnell & Co. made a response to Mr. Stock's letter, which is part of Exhibit GG?

A I don't recall.

Q Let me try to refresh your recollection by

showing you a letter dated April 16, 1969, from T. Murray McDonnell to Fred J. Stock, which has been pre-marked as Exhibit Exhibit HH for identification.

Do you recall having seen that letter on or about the date it bears, April 16, 1969?

A I don't specifically recall.

Q Are there any indications on the letter which would indicate to you that you di see the letter?

A Yes, my initials and notification to put it in the file.

Q This is not a work plan, is it, sir?

MR. BEEBE: Objection. I think it speaks for itself.

THE COURT: This is HH for identification?
MR. BROOKS: Yes.
THE COURT: Yes, I think it would speak for itself. Sustained.

MR. BROOKS: I offer first, in evidence, your Honor

THE COURT: Any objection?

MR. BEEBE: No.

THE COURT: Received.

(Defendant Stock Exchange Exhibit HH received in evidence.)

(Defendant Stock Exchange Exhibit HH read to the jury.)

Q As I understand it, Mr. Newman was breaking in

as your successor as the coordinator at this time?

A That's correct.

Q And you had planned by this time to leave the exchange for another position?

A That's correct.

Q And that decision was yours to make, was it not, sir?

A That's right.

Q Were you asked to stay at the exchange?

A Yes, I was.

Q During the remainder of the month of April while you were at the exchange did you obtain any knowledge which would indicate whether the work plan was received or not by the exchange?

A I don't recall.

Q I hope you have before you Plaintiffs' Exhibit 44A, Mr. Schuette. Is that a fact?

A Yes.

Q Mr. Beebe in discussing that exhibit with you called your attention to the words at the third paragraph in quotes, "get capital."

I will read the sentence in which that phrase appears to make some sense out of it. It says, "When pressed again to get capital McKay mentioned some two

million dollars locked in under an agreement for two years."

I believe you have testified that you were the author of this memorandum, did you not?

A Yes.

Q And I take it that you used that term "get capital" and you either typed it or instructed that it be typed in quotations, did you not?

A I don't recall if I specifically instructed that it be quoted.

Q Well, when you describe your discussion with Mr. McKay by saying "When pressed again to get capital," would getting capital have included selling some stock exchange seats which we have been told were not good capital items for cash which were good capital items?

MR. BEEBE: Objection. Hypothetical. Would it have included --

THE COURT: Sustained.

Q Mr. Schuette, what did you mean by "get capital"?

A The firm was close to, apparently near by capital ratio violations time and time again, and as such, since they were losing the possibility of additional capital here that they had already, it was a natural reaction just to tell them to get enough capital.

Q Did you care where they got the capital?

A No concern of mine.

Q Was the thrust of your message to get your ratio up, McDonnell & Company?

A That is the thrust of the message.

Q And you can get your ratio up by doing things like selling your liquid assets and turning those liquid assets to cash, can you not?

A Did you say liquid?

Q Selling liquid assets and turning them into cash. That would get up your capital ratio?

A That would get up the capital ratio, that is correct.

Q And you can clean up some of your back office problems, can you not, and get up your capital ratio?

A That is correct.

Q You weren't telling Mr. McKay to go out and solicit any particular person to put money into McDonnell & Company, were you?

A I don't think that was in the exchange's province.

Q Let's take a look at the attachment, Mr. Schuette, to Exhibit 52A. I know you have testified that you haven't seen that attachment, you didn't at the

time. That you will recall is a list of reasons prepared by somebody at McDonnell & Company addressed to somebody at McDonnell & Company which was included in the first page, which is a letter to the exchange by Murray McDonnell, arguing why restrictions shouldn't be applied. One of the reasons -- are you with me?

A Yes, I am with you now.

Q I'm sorry I got a little bit ahead. Looking at paragraph 8 on page 2 of the attachment, I would like to read that, with your Honor's permission, since it's in evidence.

It says, "Our net worth is at an all-time peak, up from $15 million on October 31, 1968, to some $19 million currently, by injection of new capital and from appreciation of assets which are non-admissible for rule 325 purposes."

Did you have knowledge of that appreciation in assets and the increase in McDonnell & Company's net worth at that time?

A I did not.

MR. BROOKS: I have no further questions.

THE COURT: Any other counsel have any questions?

MR. LOFLIN: No, your Honor.

MR. BEEBE: On redirect, your Honor.

REDIRECT EXAMINATION

BY MR. BEEBE:

Q Sir, while you have that page open, the paragraph that was just read and you said that the net worth had increased $3 million "by injection of new capital and from appreciation of assets which are non-admissible for 325 purposes."

What was the injection of new capital?

A By April 7th there was a whole host of new voting, non-voting stockholders, also some subordinated accounts that were added to the capital.

Q Do you know whether or not the subordinated accounts included our clients' accounts?

A I don't know specifically whether they did or not.

Q You knew it included some subordinated lenders, didn't you?

A Oh, yes.

Q Sir, you were asked about the draft restrictions letter that you prepared and then something that was called a work plan. Is it safe to say that the restrictions letter was laid aside and the work plan was taken up as the exchange plan of operation

at that point?

A I think that's the assumption you could make, yes, sir.

Q That's consistent with your recollection, is it not?

A Yes.

Q There was no discussion of work plans before April 9 or April 10th, was there, that you recall?

A Not that I recall. Specifically to McDonnell & Company.

Q I meant that. Thank you, sir.

Are work plans publicly disclosed?

A I don't believe they are.

Q This one was not, was it?

A I don't know.

Q You mentioned that other firms had work plans similar to this. Could you name some that come to mind?

A I could not name any specific other firm.

Q In Exhibit FF -- you do have that in front of you?

A I don't have it, no.

Q That is March 11, 1969.

A I have it.

Q The last paragraph reads:

"We understand that we may withdraw capital on April 1, 1969, if such withdrawal would not result in our capital ratio exceeding 2000 per cent."

Is it your testimony that those funds were not withdrawn on April 1?

A To the best of my knowledge, they were not withdrawn.

Q Was the reason they were not withdrawn because to do so would have resulted in the capital ratio exceeding 2000 per cent?

MR. BROOKS: I object, your Honor. He is asking for the operations of somebody else's mind.

MR. BEEBE: Straight out of the questioning on the exhibit that came in on cross.

THE COURT: Overruled, if he knows.

A Ask the question again.

THE COURT: Could it be read back, please.

(Question read)

A I assume so. I did not make the decision.

Q Sir, this speaks about --

MR. BROOKS: I move to strike the answer out. It's not based on knowledge.

THE COURT: Strike it out.

Q This document, and I believe some others that you testified about this morning, concerned $600,000 in the subordinated account and referred to -- and you referred this morning on cross-examination to additions being made to subordinated accounts at the end of January 1969. One of those accounts that you mentioned was Marjorie McDonnell. Do you remember that, sir?

A Yes, sir.

Q Marjorie McDonnell is not Margaret Mary McDonnell, is it, sir?

A I don't know. I don't know the McDonnells.

MR. BEEBE: Just so there is no confusion in the jury's mind, can we make it clear on the record and have it stipulated that the Marjorie McDonnell is not our client, the plaintiff in this case?

MR. BROOKS: I will stipulate that Marjorie T. McDonnell is T. Murray McDonnell's wife and not Margaret Mary McDonnell, the plaintiff.

THE COURT: Thank you.

Q Referring to Exhibit EE that was introduced on cross-examination. That is dated March 11, 1969.

MR. BROOKS: What exhibit?

MR. BEEBE: EE.

MR. BROOKS: That's another date.

MR. BEEBE: EEl that is.

Q Is it your testimony that McDonnell & Company had certain accounts or a certain account at that time which they offered as a capital contribution but the exchange turned them down? Was that the thrust of your testimony this morning?

A Yes, that capital was offered and it was turned down by the exchange.

Q What was the basis of turning it down?

A As I testified this morning, I don't know the legal technicalities of why the exchange turned it down. It was somewhat involved in terms of the trust agreement.

Q Is it that the exchange looked at the trust agreement and made a determination that it was not permissible for the trust to make a contribution of that nature?

A I assume so.

MR. BROOKS: I object and move to strike.

THE COURT: Strike it out.

Q Let me refer you to Exhibit EE then. This is signed by you. I am going to read to you from the first paragraph which you testified about this morning.

"According to McKay as the one and a half million dollars subordinated account under the trust agreement is not available because the exchange will not accept the terms of the trust, McDonnell & Company will be short by $520,000 to meet the 2000 per cent ratio."

Was that what Mr. McKay had told you?

A Yes.

Q And that trust is not a plaintiff in this case; is that true?

A I don't know.

MR. BEEBE: Can we stipulate to that so there is no confusion here?

THE COURT: I don't know what you mean. The record is clear.

MR. BEEBE: As long as it is clear. I thought there might be some real confusion with the way the question came out.

Q In any case, did the exchange make any examination as to the trust that is involved here, and the trust agreement that is involved here?

A I have no idea.

Q Sir, you testified this morning about your recommendation for the imposition of restrictions. That was on cross-examination.

When did you first recommend the imposition of restrictions on McDonnell & Company after you became coordinator?

A I can't specifically recall.

Q Talking about the terms, and referring specifically to your testimony yesterday when you pinpointed it as late 1968. Is that still your testimony today?

MR. BROOKS: I object. He went on to say or early 1969 in the same statement.

Q Why don't I read it to you, sir. Perhaps that would help refresh your recollection from yesterday.

THE COURT: What needs to be refreshed?

MR. BEEBE: On cross-examination he seemed to back away from that this morning and say something quite different.

Q Maybe you can just tell us your testimony now,

sir, and we can rest this matter if you are still in agreement with what you said yesterday.

THE COURT: I will sustain an objection to the question as far as it's gone on the grounds of form.

Q I will start again, sir. When did you first recommend imposition of restrictions on McDonnell & Company after you became a coordinator in May 1968?

A I couldn't specifically give you a date, Mr. Beebe, because we, in reviewing the various firms we had under our charge, we would suggest to Mr. Bishop or later Mr. Stock that maybe this firm needed to have some restrictions placed upon it, this or any other firm, and this might have happened at any one of our weekly coordinator meetings. So I can't specifically name a date.

Q Of course, sir, I am not asking you to name a precise date in July or August 1968. I am just asking you if it was, indeed, in 1968?

A I would assume that that was possible, yes.

MR. BROOKS: I move to strike, your Honor.

THE COURT: Yes, strike that out.

Q All right, then I will go after with more precision, sir.

Let me just ask you: In your testimony

yesterday you did speak in terms of late 1968, and I will read it to you and ask if that is still your testimony.

A Fine. Go ahead.

Q Starting on page 822:

"Now, you recommended imposing restrictions. What was the basis of your recommendation?

"A Specifically I don't recall. Just a general overall picture.

"Q Who did you recommend it to?

"A I believe probably the earliest recommendations were made to Mr. Bishop.

"Q This would be early in that period of June to December 1968?

"A I would say late in '68.

"Q When you said the earliest recommendations, you mean there were a series of recommendations by yourself?

"A No. The firm was already under self imposed restrictions during that period.

"Q Sir, what makes you say they were under self imposed restrictions in 1968?

"A They filed a list of the restrictions that they imposed upon the firm's operations.

"Q Do you have a copy of that here? Have you seen such a document recently?

"A I have seen such a document, yes.

"Q When did you see that, sir?

"A Oh, within the last week.

"Q And this is 1968, these self imposed restrictions?

"A Yes.

"Q Could you describe it for us?

"A They limited the number of transactions they would handle. I don't recall the specifics of it.

"Q Are you sure it could have been late in January of 1969 of that list you are talking about?

"A Those restrictions were imposed before I became the coordinator. They were self imposed, voluntary restrictions.

"Q But you recommended on top of that that the exchange impose restrictions; is that right?

"A Yes."

That was your testimony?

A That's correct.

MR. BEEBE: No further questions on redirect, sir.

THE COURT: Mr. Brooks, anything on re-cross?

MR. BROOKS: I have no further questions of Mr. Schuette.

THE COURT: Very well, sir, you may step down.

(Witness excused)

MR. BROOKS: At this time we are prepared, subject to your wishes, to read in passages from the transcript of Anna M. McDonnell as if it were cross-examination and as if she were here on the stand.

We left open whether we would at the same time read in interrogatories signed and sworn to by her. I put that question to the Court and Mr. Beebe, whether we could be permitted to do that at the same time.

THE COURT: Ithink I will permit you to do that.

MR. BEEBE: On the interrogatories, sir, I would be reading practically everything in that wasn't read by the other side. I would simply suggest we mark it as an exhibit and offer it in evidence and I would have no objection.

MR. BROOKS: I certainly don't want to mark

all of it as an exhibit.

THE COURT: You want to read some of it?

MR. BROOKS: We have five.

MR. BEEBE: My plan is to read in everything not read.

THE COURT: Is there any objection to some of them on the ground of self serving statements?

MR. BROOKS: I don't know. I think there would be if Mr. Beebe wants to mark them all.

THE COURT: Why don't you put in what you want to at this point, and then Mr. Beebe will make his offer, and we will deal with it as he makes it.

MR. BROOKS: Very well.

Since it has been shown that I am not the best reader, I am going to ask Miss Lichstein and Miss Solomon to do the reading.

Miss Solomon will take the stand and Miss Lichstein will be the interrogator.

MS. LICHSTEIN: Ladies and gentlemen, this is part of the deposition of Mrs. McDonnell, Sr., and these are portions that Mr. Beebe did not read and it's as if she were being cross-examined.

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